



Calhoun: The NPS Institutional Archive
DSpace Repository

Theses and Dissertations

1. Thesis and Dissertation Collection, all items

1968

Total banking with military pay : a step
toward electro-banking.

Gaddis, Glenn Leslie

George Washington University

<http://hdl.handle.net/10945/13301>

Downloaded from NPS Archive: Calhoun



Calhoun is the Naval Postgraduate School's public access digital repository for research materials and institutional publications created by the NPS community. Calhoun is named for Professor of Mathematics Guy K. Calhoun, NPS's first appointed -- and published -- scholarly author.

Dudley Knox Library / Naval Postgraduate School
411 Dyer Road / 1 University Circle
Monterey, California USA 93943

<http://www.nps.edu/library>

NPS ARCHIVE
1968
GADDIS, G.

TOTAL BANKING WITH MILITARY PAY:

A STEP TOWARD ELECTRO-BANKING

by

Glenn L. GADDIS

Thesis
G122



TOTAL BANKING WITH MILITARY PAY:

A STEP TOWARD ELECTRO-BANKING

by

Glenn L. GADDIS

TOTAL BANKING WITH MILITARY PAY:

A STEP TOWARD ELECTRO-BANKING

Glenn Leslie Gaddis

Bachelor of Arts

Naval Postgraduate School, 1964

A Thesis Submitted to the School of Government and
Business Administration of The George Washington
University in Partial Fulfillment of the
Requirements for the Degree of
Master of Business Administration

April, 1968

Thesis directed by

Harry Robert Page, Ph.D.

Associate Professor of Business Administration

NPS Archive

1968

Gaddis, G.

~~Thesis G122~~

TABLE OF CONTENTS

	Page
LIST OF TABLES	iv
LIST OF ILLUSTRATIONS	v
Chapter	
I. INTRODUCTION	1
Subject Area of Research	
Research Question	
Scope	
Objective	
II. CASH AND RELATED PROBLEMS	6
Cash and Check Transactions	
Allotments for Family Money	
Overdraft	
Credit	
Morale	
III. PROCEDURES: PRESENT AND FUTURE	13
Allotments	
Bank Credit and Cash Guarantee Card	
Extent of Major Types of Plans	
Essential Features of Major Plans	
Bank Credit Cards	
Check Credit	
Overdraft-Traveler's Check Plan	
Other Programs	
Some Points of Comparison	
Implications: Some Observations	
Compatible Bank Credit Cards	
Overview	
Cooperation	
Competition	
The Card	

Table of Contents continued --

Chapter	Page
Customer Relations	
Operating Rules	
The Central Facility	
Member Bank Responsibility	
Clearing Process	
Formal Organization	
Scope of Bank Credit Cards	
Electro-Banking	
IV. SUMMARY AND CONCLUSION	98
Military Banking Program an Aid	
Bank Services Available	
Services for both Military and Civilian	
Organization	
Conclusion	
Recommendation	
SELECTED BIBLIOGRAPHY	107

LIST OF TABLES

Table	Page
1. Allotments, by Type, in Effect 1 November 1967	15
2. Categories of Credit Programs	20
3. Characteristics of Revolving Check Credit Plans in the Third Federal Reserve District-- 19 Banks	27

LIST OF ILLUSTRATIONS

Figure	Page
1. Merchant Credit Card Plan	65
2. Single Bank Credit Card Plan	65
3. Compatible Bank Credit Card Plan	66
4. Card Format	76
5. Electro-Bank Monthly Statement	93

CHAPTER I

INTRODUCTION

Credit cards and retail credit have been in use for many years. Most people have at least one, and many possess a wide range of credit cards. Gasoline credit cards particularly provide a convenient method of credit all across the country. They, in fact, provide an interest free loan for as long as sixty days.

The use of credit cards and the most advanced electronic computer systems has brought about considerable speculation on an entirely new method of money and credit transaction. Some of the names given to this new method include "checkless," "cashless," and more recently, "electro-banking." Some people refer to the whole idea as "instant debt." Many responsible persons, however, do anticipate the use of "electro-credits" and have even set a time schedule for this eventuality.

"Checkless" banking may replace our current system as early as 1980. Innovations now being seriously developed by the banking industry may eliminate the need for numerous credit cards, checks--and, perhaps, cash--and at the same time expand and simplify customer services. Made possible by the use of electronic impulses as the message, the system would bring large-scale

changes in our everyday business transactions. For example, one bank ID card would provide identification, unlock the customer's bank account, and serve also as the key to his credit inquiry account at the local automated credit bureau.¹

The same time frame is noted in the article, "Cashing in on the Checkless Society," by Robert L. Kramer and W. Putnam Livingston in the Harvard Business Review.² Kramer and Livingston anticipate that the "checkless society," which will incorporate the use of electro-credits as a method of banking and point of purchase transfer of funds between the customer's account and the retail account, will be in operation and available to the public by the mid-1980's. Although the "checkless society" utilizing the full "on line" nationwide exchange of electro-credits sounds very exotic, it is still at least fifteen years away.

Many of the features which will be incorporated into total banking as envisioned for the checkless-cashless society exist within the banking industry today. One segment of our society that would benefit most from a totally integrated banking program--our active duty military families--could well be pioneers.

¹Dale L. Reistad, "The Coming Cashless Society," Business Horizons, Vol. 10, No. 3 (Fall 1967), 23-32.

²Robert L. Kramer and W. Putnam Livingston, "Cashing in on the Checkless Society," Harvard Business Review, Vol. 45, No. 5 (Sept.-Oct. 1967), 141-149.

Subject Area of Research

Interest in the possible use of "electro-banking" for military personnel was sparked for the author by the two articles noted above. He has observed in his years of military service that there is need among military families for a more universal banking system, which would be recognized worldwide and provide a "hometown bank" relationship. He has often observed that military personnel on active duty have a tendency to carry relatively large sums of money, sometimes from two or three different countries. In some instances these persons have lost their lives in airplane crashes or have been lost at sea, and the money they carried is gone forever. If a system were developed whereby a military person might utilize checks or credit cards, the loss of such instruments would not result in the loss of large sums of money.

A second aspect that will be considered in this paper is the mobility of military families, most of whom average a move every other year, requiring the establishment of credit over and over again. It is quite possible that a military banking program could utilize a universal credit card recognized everywhere. Several such cards are now quite acceptable throughout the world, notably the American Express credit card.

A third aspect which will be considered in this paper is a line of credit whereby a military person could "overdraw" his balance in conjunction with his checking account and credit card and repay this "overdraw" at a predetermined interest rate.

Research Question

The research question to be considered here is: Is it now feasible to establish, in conjunction with civilian banking institutions, a "total banking activity" including "money cards" for military personnel?

Subsidiary questions are:

- (a) Could a military banking program be an aid to military personnel? How?
- (b) What services could be made available?
- (c) Could the services of such a program be used in both the military and civilian community?
- (d) Who should organize and be responsible for the operation of such a program?

Scope

This research paper will examine the banking facilities and other activities which are now associated with military pay and the personal finance activities of military families. Although reference will be made to

military pay in general, which would include all the armed services, the study will restrict itself to the Navy. Problems found in the Navy are also found in the other services. Information used here has been obtained from the Navy Finance Center in Cleveland and from leading banks and credit card services. In addition, interviews were conducted with executives of credit card services, central charge organizations and banking institutions. Although very little information is available at the present time in hard-bound publications, "trade" magazines and banking newspapers have proven to be highly valuable.

Objective

The objective of this paper will be to present information relative to the current utilization of the military allotment of pay, and by researching the various facilities of financial institutions which are now available to military personnel, to ascertain if there is a possibility of combining existent services into a central banking program whereby the members of the military family may, in effect, have a "hometown bank" no matter in what part of the world they are located.

CHAPTER II

CASH AND RELATED PROBLEMS

Military personnel today are paid regularly and utilize the services available from banks, credit accounts of department stores, and the many other money transactions of everyday life. Because the military family is an extremely mobile unit there are procedures and related problems which require special attention. These problem areas include the carrying of large amounts of cash, the movement of cash from the military man to his family and the use of checking accounts, the establishment of credit and obtaining loans, and the use of military pay allotments.

Cash and Check Transactions

The problem of carrying cash has been recognized for a long time. The American Express Company has used as a slogan to sell traveler's checks, "Don't carry any more cash than you can afford to lose." For the same reason the Navy has for years authorized the Supply Officer on board ship to accept safe keeping deposit of cash and valuables. This allows a sailor to draw his pay and deposit the cash

with the Supply Officer to be withdrawn later when needed. A checking account does provide a degree of safety against the loss of money through the deposit of a person's pay, with checks being cashed as necessary. There is, however, often the problem of finding a facility which will accept a check. In some localities, banks will not accept checks drawn on another bank or even another branch of the same bank. Some banks and their checking accounts enjoy the reputation of "never bouncing." The Northeastern Pennsylvania National Bank and Trust Company of Scranton, Pennsylvania, is one such bank. It has as its policy for military accounts, "Our bank makes an effort not to embarrass a depositor who incurs an overdraft of a nominal amount."¹ This bank maintains the checking accounts of more than 9,000 military families all over the world. Checks drawn on the Northeastern National Bank are recognized in Navy communities as reliable and are readily acceptable.

In December, 1967, the Navy announced a personal check cashing service for use on board ship. The reason given was, "In order to encourage Navy blue jackets to develop good financial habits by the use of United States

¹Letter from S. S. Warman, Vice President, Northeastern Pennsylvania National Bank and Trust Company, Scranton, Pennsylvania, November 21, 1967.

banking services."¹ Under the new regulations, for the first time Navy disbursing officers may cash personal checks up to \$250 for sea duty members whose pay records they hold. This procedure is meant to provide a useful facility for personnel serving at sea for extended periods of time. Through this service a sailor can reduce the amount of cash carried on board, and release a larger portion of his pay for deposit by Navy allotment in his bank checking account. For example, a sailor due \$150 on pay day can draw \$50 in cash for pocket money and allot \$100 for deposit in a United States bank through the Navy disbursing system, knowing that if he needs another \$50 before the next pay day he can cash a personal check. Prior to adoption of the check-cashing service, many sailors were inclined to draw their entire pay in cash. This procedure will also be a benefit to disbursing officers by reducing the number of safekeeping deposits that they would otherwise have to hold and account for at personal risk.

Allotments for Family Money

The problem of transferring cash from a shipboard sailor to his family has been partially solved by the use

¹Navy Comptroller Review, Department of the Navy, Washington, D. C., December, 1967, Vol. XIV, No. 4, p. 3.

of allotments. Some sailors prefer to receive all their pay themselves and then mail or carry it home to their families. For the military man who does this, an unexpected ship's movement or delay in the mail causes a hardship on his family. The use of the allotment insures that the family will receive money on time each month. If the check is sent directly to the wife, she is faced with the problem of safekeeping the entire sum. The use of a checking account provides both safety and convenience for the paying of bills by mail or check. As of November, 1967, out of a total of 728,261 active duty Navy personnel, 291,205 were using allotments to provide their families with money either directly or via allotment to a bank checking account. These allotments amounted to \$50,488,733.22¹ in that month.

There are a number of problems associated with allotments. The most frequent one is that of a change of address to which the allotment is mailed. The delay and/or time lag in changing address or forwarding an allotment is a prime source of dissatisfaction at the time of moving on permanent change of duty. This is especially troublesome because of the need of additional financial flexibility at such times. A delay in the receipt of an allotment by a

¹Letter from Captain J. W. Cartee, SC, USN, Commanding Officer, Navy Finance Center, Cleveland, Ohio, November 13, 1967.

bank when the checking account is being changed can cause great embarrassment to the military family.

One way to avoid the problem of time lag is to continue to have the allotment sent to the same bank checking account. This action does not solve the problem unless the bank is well recognized and its checks are readily acceptable. If a check is not readily acceptable, there will be the problem of establishing a source of pocket money for the military wife whose husband is at sea or on foreign duty. There have been instances in which a military banking facility has refused to cash personal checks other than those drawn on its own bank. Such action is usually a maneuver to harass the military member or his family into moving their account to that bank. The Navy Exchange System is authorized to cash only up to \$50 per day, which is not always enough to meet current needs. Also, commissary stores can accept a check for the amount of the purchase only.

Overdraft

The problems of overdrafts or bounced checks are especially serious in the military services. In 1966, the Department of the Navy initiated a policy whereby each Navy Exchange and Commissary Store would notify the military member of all returned checks, and at the same time forward

a copy of the notification to his Commanding Officer and the Bureau of Naval Personnel for inclusion in his official record. A returned check, thus, not only causes embarrassment but could also have a detrimental effect on the career of a military person. This could be true even though a mistake or an error was committed by the bank.

Credit

Military families often find it difficult to obtain needed credit at reasonable rates. Many are not aware of the actual interest rates charged by the "friendly loan agents" located just outside the main gate of almost every base or station. The more reputable loan companies and those with reasonable rates of interest require time to process loan applications. This waiting time can cause hardships or "force" a family to seek a loan at the fast but expensive source. Credit unions and especially the Navy Federal Credit Union have been of assistance in solving this problem, but their services are not always accessible.

Morale

Morale is of concern to military commanders. The military man is equally concerned with the morale of his family. Pay and family money matters have the greatest potential to either cause problems or to provide a basis

for good morale in the family. The important point is not necessarily a greater amount of money, but an orderly and planned flow. Savings and credit are valuable parts of a well organized family financial program. The military pay procedure, if used in conjunction with present and proposed banking programs, can provide greater peace of mind for the military family, and with it, enhanced morale.

CHAPTER III

PROCEDURES: PRESENT AND FUTURE

To facilitate transfer of funds and credit transactions for military personnel, a number of procedures are available singly. This chapter will describe various procedures in use at the present time and those anticipated, as well as steps that have been taken towards combining them for greater service.

Allotments

The military services now provide an allotment procedure whereby specified sums of money from the military or retired pay are forwarded to designated persons or organizations monthly. Allotments are used to pay insurance premiums, make FHA home mortgage payments, and send money to persons or banks. A single check is used to forward more than \$2.6 million to one institution representing the aggregate of 26,448 allotments.¹ A second such check to

¹Letter from Captain J. W. Carter, SC, USN, Commanding Officer, Navy Finance Center, Cleveland, Ohio, November 13, 1967.

another institution in the amount of \$1.3 million represents 4,477 allotment accounts.

The pay of any military person can be allotted at his request for the purposes authorized. Each type of allotment carries an identifying letter. These purposes include: Savings to banks, savings and loan associations or credit unions (S), checks to families of enlisted personnel (Q), checks to families or to family checking accounts of enlisted or officer personnel (D), payments of FHA mortgages (H), payment of insurance premiums (I), and special insurance premium payments to Navy Mutual Aid (M) and National Service Life Insurance (N).

Table 1 indicates the type and number of allotments in effect on 1 November 1967. These allotments were made at the request of 728,261 naval personnel, and amounted to \$74,882,081.67 for that month.

This table points out the fact that many naval personnel are not at the present time using the allotment as a method of transferring money. This may be due to lack of information about allotments or their acceptability by banks for mortgages and checking accounts, as well as savings institutions and insurance companies.

TABLE 1

ALLOTMENTS, BY TYPE, IN EFFECT 1 NOVEMBER 1967

Type Allotment	Number of Allotments
S	226,105
Q	76,772
D	214,433
H	2,904
I	372,294
M*	26,141
M*	3,301
N	108,997

*26,141 officers have Navy Mutual Aid Insurance and 3,301 of these pay an additional premium because they are aviation personnel.

Source: Navy Finance Center

Bank Credit and Cash Guarantee Card

The use of bank credit card plans, including "Check Guarantee Cards," may well become an important segment of a total banking program for the military services. These plans are also of concern to those who espouse the early adaptation of "electro-banking." Details on the major features of these plans may also be useful in assessing more fully some of their implications for military banking program.

Credit card programs, as such, have until recently developed along two lines: first, those operated on a national level by nonbank organizations primarily for financing travel and entertainment expenditures (American Express, Diners Club, Carte Blanche); second, those operated locally by banks for financing retail sales. Recently some nonbank organizations have initiated programs (still largely restricted to travel and entertainment) intended for banks, while banks (Bank Americard) or groups of banks (in Illinois, California, Michigan, Connecticut) have launched or are studying plans for local retail bank credit cards on a national or regional basis.

In addition to the straight credit card program, there are other related forms of credit which banks may operate, alone or simultaneously with a credit card plan. Revolving check credit, although certainly not new, must be considered because (1) it achieves a somewhat similar result without the use of a credit card or the necessity for including the merchant in the plan, and (2), perhaps more important, it is an essential element in other programs which may have implications parallel to credit cards. For example, one well known plan (referred to below as an "overdraft-travelers check" plan), launched in Boston in June, 1966, and already accepted by over 130 banks

throughout the country, is a rather extreme variant or extension of the check credit theme with some features of the credit card device.¹ The novelty of the total plan and its rapid spread would appear to justify the separate consideration given to it below.

A Federal Reserve Bank survey in 1966 found that at that time very few New England banks had made a firm decision about the adoption of a credit card plan. Conversations with bankers suggest that they are intentionally being cautious, partly because they are well aware of past "failures" in bank credit card programs and the admittedly high start-up costs of such plans, and partly because they are uncertain as to the kind of program which will best meet their particular needs.

On the other hand, the survey did indicate that many bankers feel they will be forced by the pressures of competition to make a decision in the near future, presumably in favor of some kind of expanded consumer credit program similar to those considered here. Hence, they are giving serious consideration to the possibilities open to them. In particular, having some knowledge of the problems of an independent credit card plan, many are expressing

¹Letter from Edward V. Hickey, New England Merchants National Bank, Prudential Center, Boston, Mass. "Evergreen Account," December 19, 1967.

interest in (1) regional interchange programs and (2) competing ideas, some of which involve the extension of revolving check credit into an overdraft plan, thus tying the line of credit directly to the checking account.

Despite the great interest expressed in these various programs, there is as yet little evidence that their development will be such as to have a significant impact, in either a quantitative or qualitative way, on the payment mechanism in the near future. Nevertheless, if and when such programs become more common, such as with the broad base of over three and a half million military families, they can contribute to a gradually accumulating amount of knowledge and experience on the part of those most concerned--bankers, retailers and consumers--with respect to the procedures and technology most suitable for a more automatic nationwide credit transfer process. Credit card and check guarantee card plans may help especially in problems at the point of retail transactions, while overdraft loan types of programs may contribute by relating more closely to bank procedures for an automatic extension of credit to the account settlements and customer statements. This would be especially helpful at time of transfer between duty stations. It is to be remembered also, that credit cards are simply one of the

many developments in recent years which have the effect, if not the intent, of reducing the volume of checks and/or improving the check settlement mechanism in a variety of ways.

Extent of Major Types of Plans

Because of the complexity and cost involved in establishing a credit card program, the Federal Reserve Bank of Boston survey included only the larger member banks in the district since they are located in the areas of greatest population concentration and trading activity. Accordingly, member banks with deposits of \$50,000,000 and over, of which there are thirty, were used in the survey. Results by major category of program are indicated in the following table.

It should be noted that only six banks have a regular credit card program and two of the six have been in operation for several years while four are just becoming operative. Seven of the ten check credit programs have been in existence for more than five years. In addition, plans for the actual implementation of the overdraft-travelers check program are either incomplete or non-existent on the part of some of the banks which have paid for this franchise. Moreover, most banks have adopted a "wait and see and in the meantime let's study them"

attitude toward straight bank credit card programs.¹

TABLE 2
CATEGORIES OF CREDIT PROGRAM

Type of Plan	Number of Banks ^a	Approximate Length of Time in Operation				
		Just start- ing	Less than 1 Year	1-5 Years	5-10 Years	Over 10 Years
Credit Card	6 ^b	4			1	1
Check Credit	10		3	4	2	1
Overdraft- Travelers Check	7	3	(4 not yet started)			
Other	2		1	1		
None	9					

^aDoes not add to 30 because of duplications, i.e., four of the banks have two plans each, in the following combinations: overdraft-travelers check and credit card; overdraft-travelers check and check credit; credit card and check credit; check credit and other.

^bIt is possible that credit cards are more widespread than is indicated by the sample used in this survey, but contacts with bankers do not suggest so. On the contrary, several of the large banks do not have any such plans under active consideration. Moreover, to date our attention has been called to only one bank in the less-than-\$50,000,000-deposit category which has a credit card plan, while nine banks in this category have adopted the overdraft-travelers check plan.

Source: Federal Reserve Bank, Boston.

¹"Bank Credit Card and Related Plans," New England Review, December, 1966, p. 3.

On the other hand, the inconclusiveness of the figures in the sample may well disguise and understate the nature and significance of present and impending developments in the programs under consideration here. Several plans, some national and others regional in coverage, are just now in the stage of being presented to banks for their consideration. Most bankers, feeling the mounting pressure of competition and being increasingly aware of the possibilities of automation in relation to credit operations,¹ feel that it is simply a matter of time before they will have to enter the credit card field too. However, all banks will not adopt the same type of program. Each will select that plan--credit card, check credit, overdraft or some other variant--which seems to meet its needs best. Nevertheless, many of these may well have similar effects on the payments process. Or, it is conceivable that over a period of time the variety of plans may tend to converge toward a common system.

For these reasons, the following sections will describe the essential features of each of the major types of programs, providing a partial basis² for consideration

¹The American Bankers Association publishes annually the National Automation Conference which presents papers and projects of its sessions covering the most recent developments in automated bank.

²In the absence of detailed case studies of the

of the relative strengths and weaknesses of each and thus some indication of the chances of its survival and potential impact on the payments mechanism.

Essential Features of Major Plans¹

Bank Credit Cards.--Bank retail credit card programs are basically a means by which a bank in one process finances the consumer's purchases and the retailer's accounts receivable. Since the major features of these plans, including those in the New England banks, are quite similar, the following description is a composite of the plans found in the six banks described in the Federal Reserve Bank, Boston, survey.²

The consumer becomes a cardholder by meeting the bank's credit requirements and having a line of credit

results of individual programs, this seems to be the only basis for evaluation at this time, other than the subjective comments of participants which will be referred to below.

¹Recently developed nonbank-sponsored bank credit card plans (Diners Club, Carte Blanche) are not included because they are still more concerned with travel and entertainment expenditures and with higher income and credit rating groups than are retail credit cards. However, the volume generated by these plans as well as their potential move to the local retail level suggests that they may become increasingly relevant to the problem at hand. The recent affiliation of Carte Blanche with the First National City Bank and American Express with numerous banks under their "Executive Credit" plan indicates a new trend.

²Bank Credit Card and Related Plans, op. cit., pp. 6-25.

established for him. Usually the card has an expiration date of six months or one year, at the end of which the bank can reassess the credit rating of the customer and cancel the card if necessary. Each bank has an announced credit ceiling for loans in the program. (\$300-\$500 was most frequently mentioned, although it was felt that the ceiling would gradually be raised if and when experience justified it.)¹ However, the maximum for each individual cardholder will vary with his credit rating. In addition, it is customary to have "floor limits" (\$25, \$50, and \$100 were most frequently mentioned) on each transaction, which may be exceeded only after the merchant obtains the bank's approval. This is a safeguard against the so-called "runaway" card.

The merchant, usually on a daily basis, deposits the sales slips generated from transactions under the plan and receives immediate credit for that amount less the bank's discount. In turn, the bank bills the cardholder monthly for the total amount charged at the various stores participating in the plan. The sales slips which the merchant deposited with the bank may be included with the

¹A survey in the Third Federal Reserve District of 19 banks revealed six banks with ceilings of \$5,000 and one that exceeded that limit. "First Phase A-OK, All Systems Go," Business Review, Federal Reserve Bank of Philadelphia, November, 1966, p. 11.



statement. Normally the bank makes a photographic record of these sales slips and the credit card agreement states that such records are sufficient to establish the customer's liability in the event of any action or dispute.

Income to the bank is derived from two sources-- interest or service charges on consumer loans and merchant discounts and fees. Although the consumer does not pay for the credit card and is not charged interest for any bill paid within a grace period (usually twenty-five or thirty days), he does pay a service charge of 1 to 1½ per cent per month on any unpaid balance. Almost without exception, the cardholder is required to repay at the monthly rate of \$10 or 1/10 of the amount borrowed, whichever is greater. The retailer pays (1) an entrance fee upon joining the plan, (2) an annual rental fee or sometimes an outright purchase price for the sales slip imprinter (although on some occasions the bank may provide these without charge), and (3) a discount on the sales slip deposits, which may vary from 2 to 7 per cent depending on the volume of sales generated by the merchant.¹

In addition to the features described thus far, which are common to all credit card plans, there are a few

¹To this point card services follow the same methods, including the sources of income. The Central

variations of interest mainly because they may illustrate the attempt by individual banks to surpass their competition by extending consumer services or simply to deal with particular customer grievances concerning present services. For example, some banks advertise that a certain amount of life insurance goes into effect automatically whenever the cardholder elects to extend his borrowing beyond the grace period. Again, it is not uncommon for a "cash advance" or "instant money" privilege to accompany the credit card. Under this arrangement, the cardholder may in effect borrow cash up to a set maximum upon presentation of his card at any of the bank's branches. The amount borrowed is then added to the outstanding balance in the customer's account. (An extended version of this check cashing privilege, adopted as an independent program by one bank, is described more fully in the section below on "Other Plans").¹ It is sometimes asserted as a peripheral benefit of the credit card that a cardholder who is a regular checking account customer may use the card as a virtually uncontestable means

Charge Service of Washington, D. C., a regional card service covering parts of Maryland, Virginia, and Delaware with 5,000 merchants enrolled, has one million cardholders. Interview with Mr. J. J. Lockwood, General Credit Manager and Mr. Duane J. Novosedliak, Assistant Secretary, November 29, 1967.

¹Worcester County National Bank, Worcester, Mass.

of identification for cashing his own personal checks at any of the bank's branches where he might otherwise be unknown.¹

Check Credit.--Revolving check credit is in effect a straight consumer loan type of program. In the past it has been offered by banks as simply another form of consumer installment financing. More recently, however, check credit appears in some banks to have been relegated to the position of a comparatively unadvertised supplement to the newly established credit card program, while for other banks it is viewed as a relatively uncomplicated and inexpensive, although perhaps temporary, means of competing with credit cards.² The revolving check credit type of procedure is relevant to this paper also because the recently launched overdraft-travelers check plan appears to be an extension of check credit and is in some respects a direct competitor of bank credit cards with many similar implications.

Under a check credit plan the consumer obtains from

¹First National City Bank, New York, New York.

²An exception to this latter point is the First National Bank of Boston which early in 1966 installed a check credit plan although it has had a credit card program in operation for many years. The reason given for the initiation of the check credit program was that it was aimed at a different group of borrowers.

the bank a revolving line of credit just as under a credit card plan. However, in place of the charge card he is given a book of checks, specially numbered or otherwise uniquely identified. Use of the check to make purchases constitutes a loan by the bank for which the consumer pays a 1 to 1½ per cent service charge per month on the unpaid balance. In addition, the customer may be required to pay a fixed amount for each check as in a regular checking account.

Revolving check credit plans have been in operation in the Third Federal Reserve District since 1959. The following table indicates the characteristics of these plans in nineteen banks as of 1965.¹

TABLE 3

CHARACTERISTICS OF REVOLVING CHECK CREDIT PLANS
IN THE THIRD FEDERAL RESERVE DISTRICT--19 BANKS

Monthly Repayment Terms	No. of Banks
1/20 approved line	6
1/24 approved line	5
1/25 approved line	1
1/20 amount in use	3
1/21 amount in use	1
1/24 amount in use	3

(continued on next page)

¹"First Phase A-OK, All Systems Go," loc. cit.



Table 3 continued--

Maximum Line (Statutory maximums: Pa. - \$5,000; N.J. - \$2,500; Del. - none)	No. of Banks
\$2,400	1
\$2,500	8
\$3,500	3
\$5,000	6
over \$5,000	1

Typical Approved Line	Median	Range
Phila.	\$ 904	\$700-\$1,500
Pa. (outside Phila.)	\$1,000	\$900-\$1,200
N.J.	\$1,000	\$787-\$1,274
Del.	a	a

Interest Rate Per Month

1% outstanding balance--all banks surveyed in N.J. and Del., and those in Pa. that include life insurance

.998% outstanding balance--Pa. banks that do not include life insurance

Minimum Size Check	No. of Banks
\$20	2
\$25	9
\$50	1
\$100	1
no minimum	6

Percentage of Line in Use	Median	Range
Phila.	60.4%	60% - 66%
Pa. (outside Phila.)	64.5%	52% - 85%
N.J.	66%	55% - 75%
Del.	a	a

^aOnly two banks in Delaware offer revolving check credit plans; specifics are omitted to preclude identification. Typical approved line in Delaware tends to be higher than in other sectors of the District; percentage of line in use tends to be lower.

Source: Federal Reserve Bank, Philadelphia

Overdraft-Traveler's Check Plan.--The franchise for a quite different but related type of program has now been acquired by over 130 banks.¹ Referred to as "a marriage between check credit and the regular checking account," additional features make a package which its sponsors regard as superior to credit card plans for competitive purposes in the foreseeable future.

To participate in this plan one must have a checking account with the bank, file an application, and establish eligibility for a line of credit. The depositor then receives in addition to his regular checks, (1) up to a \$2,500 cash reserve or line of credit behind his checking account, (2) a supply of special travelers checks, and (3) an identification card.

The cash reserve is simply a revolving check credit but it entitles the depositor to overdraw his regular checking account, to the extent of his line of credit, by the use of either his regular checks or the special travelers checks. Thus, whenever the depositor writes a check for an amount in excess of the balance in his regular account, additional funds (in units of \$100) are automatically credited to his account.

¹"Security First National Bank of L.A. will 'Go National' Through License with Other Banks," American Banker, May 25, 1966.

The special checks are direct obligations of the bank and designed to be used like any other types of travelers check. Each check may be written for any specific amount, up to a maximum of \$25, \$50 or \$100 as designated on the check itself, and that amount is deducted from the depositor's balance.¹ In order to use these checks the depositor must show his identification card--a protection against the use of lost or stolen checks. An added benefit from the identification card, it is asserted, is that it entitles the owner to cash personal checks without delay at any office of the bank. This feature is not without merit, perhaps, to the depositor who has experienced difficulty in establishing his identity for check cashing purposes at a branch office.

A final element in the plan is a common one in loan programs--the protection of credit life insurance for the depositor to the extent of his use of the cash reserve feature.

¹A similar plan is under study by the Navy Federal Credit Union, which is an advanced loan to go into effect when the check is used. The total loan may be as large as \$700, the checks are made payable to the borrower in the amounts of \$25, \$50, or \$100 and require an endorsement at the time of use. This endorsement commences the loan in the amount cashed. The rate of interest is .8 per cent per month of the outstanding balance. The plan is known as POP, Point of Purchase.

The costs to the user of the check plan are of three kinds: (1) fifty cents per month, (2) the normal checking account charges of the bank, (3) one percent interest on the loan balance. If the loan is repaid within a ten-day grace period, there is no interest charge. Minimum repayment terms are the customary monthly \$10 or 1/10 of the loan balance, whichever is greater.

Other Programs.--The two plans described here are included because they represent interesting competitive variations on parts of programs outlined above and hence they may in some respects add to developments in the same general direction.

(1) Special Overdraft-Loan Account.--This plan, initiated in June, 1966, is somewhat comparable to the one above in that it represents a partial tie between the bank's revolving check credit program and its regular checking accounts.¹ This service, however, does not include a travelers check and the special account is actually still separate from the regular checking account. The depositor who wishes to participate establishes a maximum credit line (the bank's general announced maximum is \$4,800). He then in effect has two accounts, his regular checking account and a special loan account, and he receives two kinds of

¹Industrial National Bank, Providence, Rhode Island.

checks, regular and special, differentiated only by color and a code number. Any use of the special check constitutes a loan from the so-called "cash reserve" even though the depositor has a positive balance in his checking account.¹ However, a regular check may be drawn in an amount exceeding the checking balance and the bank will automatically transfer the required amount, in multiples of \$50, from the cash reserve to cover the overdraft. The depositor receives two monthly statements, one for his checking account and one for his special loan account whenever the latter is activated by use of either a special check or an overdraft on his regular account.

Loan repayment is by a pre-established schedule, with the monthly payment depending upon the amount borrowed, although a minimum of \$15 per month is required for loans under \$360. The cost to the depositor for this program consists of one per cent interest charge per month on the average loan outstanding plus the normal charge per check for both regular and special checks.

(2) Check Cashing Guarantee Card.--Everyone with a checking account is given, at no charge, an identification card. New depositors receive the card only upon

¹By comparison, the travelers check previously described is drawn against the regular checking account.

presentation of satisfactory references or after the lapse of a period of about 90 days during which the depositor has established an acceptable deposit record.

Introduced in Boston in the fall of 1965, the plan in its first phase offered simply an identification and check cashing guarantee card enabling the holder to cash checks up to \$50 in some 60 local area supermarkets of leading chains as well as at the bank's many branches.

It is to be noted that this plan has no cash reserve or loan aspect connected with it. However, according to the bank it has been successful in helping to attract depositors.

Some Points of Comparison

With the exception of the check cashing guarantee card, which is strictly a deposit service with no cash reserve or check credit feature attached to it, all of the programs described above are essentially forms of installment credit. However, there are certain important differences among them--important here because they lead to contrasting advantages and/or disadvantages of each plan from a competitive viewpoint, with possibly different kinds of impacts on the payments mechanism (although as is suggested later, all may tend ultimately to work in the same direction).

Basically, a bank retail credit card program involves charge account banking, whereby the bank finances the purchases of the consumer and the accounts receivable of the merchant through the charge card and revolving credit devices. Check credit includes a similar revolving line of credit but eliminates the use of credit cards and does not involve the financing of account receivable of merchants. In contrast to credit card and check credit plans, under the overdraft-travelers check plan the consumer must be a depositor of the bank. His line of credit or so-called cash reserve is in the form of an overdraft privilege on his regular checking account, regardless of whether he uses his regular checks or the travelers checks to make the transaction. The special overdraft-loan account plan described above also includes the overdraft by either the regular or special check, but the use of the special check always results in a loan regardless of the size of the checking account balance.¹

Given the essential similarities and differences in

¹In response to the BankAmericard plan by Bank of America, Security First National Bank of Los Angeles has recently introduced an overdraft system in which a customer using his regular checking account can draw upon a pre-arranged line of credit, with no special checks or separate accounts involved. In addition, Security First will issue to these depositors, at no charge, a Check Guarantee Card whereby it "guarantees payment on all Security First personalized checks for either cash or merchandise, up to \$100."

the major plans, some of the more important advantages and disadvantages of each can be summarized in a fairly clearcut way. However, the quantitative assessment of them by a bank for competitive purposes may be quite a different matter.

A credit card plan, from the point of view of the bank, can be a highly profitable operation. In addition to the direct income from consumer loans and merchant discounts, it can be used to attract new depositors, both merchant and individual consumer, and these in turn may be induced to make use of other services of the bank. Moreover, the major promotional effort required for both the launching and the continuing success of a credit card program may result in the creation of a new and expanded image of the bank.

For the merchant, a credit card plan, if sufficiently widely accepted and used by the public or the military as a group, may result in a reduction (but not elimination) of accounts receivable and customer credit problems, a better cash position, and an increase in sales. To the consumer a credit card means immediate credit with participating retailers and the convenience of a smaller pocket cash requirement.

On the other side of the picture, a major



disadvantage of a credit card plan for the bank is its invariably high startup cost, including promotional programs aimed at both consumer and merchant, installation of imprinters, enrollment of cardholders, and acquisition of computer facilities if not already available.¹ Moreover, experience has shown that the bank may face a rather prolonged period (probably several years) of losses on the plan, during which it will be necessary to sustain its promotional campaign.

Obviously, to be successful the bank must induce retailers to participate in the plan and consumers to make use of the charge card. Hence, any grounds for retailer or consumer opposition or dissatisfaction also constitute obstacles for the bank. Merchants may not be receptive because of the cost involved: entrance fee, imprinter rental or purchase, discounts. In addition, the merchant must establish an account with the bank if he is not already a depositor, sign a contract, and submit to all the usual details of a bank credit card transaction--including

¹Comments from bankers in this survey as well as from other sources suggest that although computer facilities have not been absolutely essential to a successful credit card operation in the past, they will probably become increasingly so in the future as competition becomes more severe. At present, the Central Charge Service, Washington, D. C. with 5,000 merchants enrolled and one million cardholders, does not have a computer installation.



the use of the charge slip, imprinter, daily deposit of sales slips, referral to the bank on sales in excess of the "floor limit," and lists of lost and stolen cards. Moreover, it should be remembered, the merchant will still have to conduct his own credit operation since not all of his customers will be credit cardholders. At the same time, experience to date shows that large chain and department stores do not as yet participate in bank credit card plans, the result being that the bank must attract a large number of small and medium size merchants if it is to achieve the volume necessary for profitable operation.

With respect to the consumer, the bank is faced with obtaining his acceptance of the charge plan--even though many merchants may not participate in the plan and the consumer may still prefer to use cash or pay his bills by separate checks. It is not difficult to put the charge card in the hands of a large number of people. The problem is in making sure that the cardholders are creditworthy and that enough of them make sufficiently active use of the cards to create an adequate volume of total billings under the plan. At this point the bank is confronted with a dilemma and what many bankers believe to be the source of the real danger in a credit card program. In order to persuade merchants to join the program the bank must give



evidence of having at least a potentially large number of cardholders, but indiscriminate issuance of cards on the basis of too lenient credit standards may mean high credit losses. It is to be remembered that in accepting the merchant's daily sales slips for deposit the bank acquires these receivables without recourse, except in instances when the merchant has given credit in excess of the "floor limit" without prior approval by the bank.

As already indicated, revolving check credit is a much simpler and less expensive type of program and in some respects may be regarded as either a partial alternative or a supplement to a credit card plan. Since the bank finances only the consumer, there is no merchant solicitation of any kind under check credit. In turn, the consumer is not restricted in his purchases to participating merchants, although credit card plans may to some extent offset this by offering an "instant cash" feature.

With check credit the bank can ordinarily be more selective in its credit exposure and retain closer control over it than under a credit card program where there is necessarily pressure to achieve a relatively widespread distribution of charge cards. Also, since check credit transactions are normally for larger amounts than credit card purchases, the bank may be able to achieve



profitability on a smaller volume of transactions through the check credit method.

On the other hand, a check credit program does not by itself create as many avenues for increasing the bank's total business as does a credit card plan. For example, a merchant who wishes to participate in the single bank credit card plan becomes a depositor of the bank if he is not already one. In addition, banks launching charge card programs indicate their belief that the additional services rendered the consumers, over and beyond the mere loan aspect in the check credit plan, will entice many cardholders to become customers of the bank's other departments. If true, this is an important result for the banks because most indicate that the majority of borrowers under ordinary check credit programs are not depositors of the lending bank. The attraction of new deposits is thought to be especially important by some banks now in a period of tight money because with the launching of the kinds of programs discussed here the banks may give the appearance of easily expanding consumer credit when they are rationing credit to business.

The extent to which check credit is viewed as a partial alternative or competitor for a credit card plan is a temporary one at best. Competitive pressures are



presently in the direction of the extension of bank consumer financing services well beyond the scope of simple revolving check credit. Newly created programs with the overdraft feature--such as those described above--may be important here not only because they compete with credit cards but also because they all have the common element of tying the revolving line of credit directly to a regular checking account. Experience gained in programs involving this type of relationship may be beneficial in any future development of a direct "on-line," "electro-banking" connection between credit card charge transactions and consumer checking accounts.¹ Hence, it is suggested that this aspect, as well as the immediate competitive importance of a plan such as the overdraft-travelers check idea, be kept in mind in any consideration of its strengths and weaknesses.

To the military family this latter plan offers the convenience and security of an overdraft or cash reserve behind his regular checking account, which costs nothing unless used--except for the annual membership fee now ranging from \$5 to \$8 depending on the issuing bank. In

¹In particular, it could contribute to the development of what Governor George Mitchell refers to as "a credit system which ties settlement accounting into quasi-automatic credit extension." American Economic Review, May, 1966, p. 164.

the following:

1. The first two conditions are satisfied.

2. The third condition is satisfied.

3. The fourth condition is satisfied.

4. The fifth condition is satisfied.

5. The sixth condition is satisfied.

6. The seventh condition is satisfied.

7. The eighth condition is satisfied.

8. The ninth condition is satisfied.

9. The tenth condition is satisfied.

10. The eleventh condition is satisfied.

11. The twelfth condition is satisfied.

12. The thirteenth condition is satisfied.

13. The fourteenth condition is satisfied.

14. The fifteenth condition is satisfied.

15. The sixteenth condition is satisfied.

16. The seventeenth condition is satisfied.

17. The eighteenth condition is satisfied.

18. The nineteenth condition is satisfied.

19. The twentieth condition is satisfied.

20. The twenty-first condition is satisfied.

21. The twenty-second condition is satisfied.

22. The twenty-third condition is satisfied.

23. The twenty-fourth condition is satisfied.

24. The twenty-fifth condition is satisfied.

25. The twenty-sixth condition is satisfied.

26. The twenty-seventh condition is satisfied.

27. The twenty-eighth condition is satisfied.

28. The twenty-ninth condition is satisfied.

29. The thirtieth condition is satisfied.

the special travelers check the user finds some features superior to both ordinary travelers checks and conventional credit cards--or so it is asserted.¹ A direct obligation of the bank, it is supposedly acceptable everywhere that any travelers check would be and is not limited to retail establishments belonging to a particular credit card plan. Again, in contrast to conventional travelers checks, these are not paid for in advance but only when used--and then through the same procedure and at the same rate as regular checks. Finally, as compared to the inherent dangers from lost or stolen credit cards, the special travelers check is personalized and its use is possible only with the accompanying identification card.

To retailers the overdraft-travelers check concept has an obvious immediate appeal: they pay nothing to handle the special checks, and hence they "save" the 2 to 7 percent discount paid to the bank under a credit card plan. In addition, the travelers check is handled as any ordinary check, and the merchant need not concern himself with charge slips, imprinters, "floor limits," lost or stolen card lists and the other details of a credit card plan. On the other hand, neither is the merchant relieved of financing his receivables unless the travelers checks

¹First/Group, Inc., Boston, Mass.



are a complete substitute for credit cards--a point which its originators have not asserted.

From the bank's point of view a major advantage of this plan is that it avoids the admittedly heavy startup costs associated with a credit card operation. To join the program a bank pays a franchise fee of \$10 for each \$1 million of its deposits.¹ The sponsoring organization contracts to spend part of the franchise fees in promoting the program among merchants as well as prospective card-holders. Nevertheless, this does not mean that a participating bank need incur no promotional or solicitation expenditures. If the plan is to be financially worthwhile, retailers must be familiar with and willing to accept the travelers checks.

Even more important, if this plan is actually to compete with credit cards, the consumer must be willing to use the travelers checks as frequently as he would a credit card, and on this there are several reasons for skepticism. Membership in the plan now costs the consumer from \$5 to \$8 per year, whereas there is usually no charge for a bank credit card. The checks themselves are less convenient, as compared to credit cards, in that they must be written out

¹This is to be compared with the BankAmericard franchise fee of an initial \$25,000 plus an "override" ranging from zero to one-half percent of volume.

The first part of the paper discusses the importance of the
 research and the objectives of the study. It also outlines the
 methodology used in the study and the data sources. The second
 part of the paper presents the results of the study and discusses
 the implications of the findings. The third part of the paper
 concludes the study and provides recommendations for future
 research. The fourth part of the paper provides a list of
 references. The fifth part of the paper provides a list of
 figures and tables. The sixth part of the paper provides a
 list of appendices. The seventh part of the paper provides a
 list of footnotes. The eighth part of the paper provides a
 list of glossary. The ninth part of the paper provides a
 list of abbreviations. The tenth part of the paper provides a
 list of symbols. The eleventh part of the paper provides a
 list of units. The twelfth part of the paper provides a
 list of formulas. The thirteenth part of the paper provides a
 list of equations. The fourteenth part of the paper provides a
 list of diagrams. The fifteenth part of the paper provides a
 list of maps. The sixteenth part of the paper provides a
 list of photographs. The seventeenth part of the paper provides a
 list of illustrations. The eighteenth part of the paper provides a
 list of charts. The nineteenth part of the paper provides a
 list of graphs. The twentieth part of the paper provides a
 list of tables. The twenty-first part of the paper provides a
 list of figures. The twenty-second part of the paper provides a
 list of tables. The twenty-third part of the paper provides a
 list of figures. The twenty-fourth part of the paper provides a
 list of tables. The twenty-fifth part of the paper provides a
 list of figures. The twenty-sixth part of the paper provides a
 list of tables. The twenty-seventh part of the paper provides a
 list of figures. The twenty-eighth part of the paper provides a
 list of tables. The twenty-ninth part of the paper provides a
 list of figures. The thirtieth part of the paper provides a
 list of tables. The thirty-first part of the paper provides a
 list of figures. The thirty-second part of the paper provides a
 list of tables. The thirty-third part of the paper provides a
 list of figures. The thirty-fourth part of the paper provides a
 list of tables. The thirty-fifth part of the paper provides a
 list of figures. The thirty-sixth part of the paper provides a
 list of tables. The thirty-seventh part of the paper provides a
 list of figures. The thirty-eighth part of the paper provides a
 list of tables. The thirty-ninth part of the paper provides a
 list of figures. The fortieth part of the paper provides a
 list of tables. The forty-first part of the paper provides a
 list of figures. The forty-second part of the paper provides a
 list of tables. The forty-third part of the paper provides a
 list of figures. The forty-fourth part of the paper provides a
 list of tables. The forty-fifth part of the paper provides a
 list of figures. The forty-sixth part of the paper provides a
 list of tables. The forty-seventh part of the paper provides a
 list of figures. The forty-eighth part of the paper provides a
 list of tables. The forty-ninth part of the paper provides a
 list of figures. The fiftieth part of the paper provides a
 list of tables. The fifty-first part of the paper provides a
 list of figures. The fifty-second part of the paper provides a
 list of tables. The fifty-third part of the paper provides a
 list of figures. The fifty-fourth part of the paper provides a
 list of tables. The fifty-fifth part of the paper provides a
 list of figures. The fifty-sixth part of the paper provides a
 list of tables. The fifty-seventh part of the paper provides a
 list of figures. The fifty-eighth part of the paper provides a
 list of tables. The fifty-ninth part of the paper provides a
 list of figures. The sixtieth part of the paper provides a
 list of tables. The sixty-first part of the paper provides a
 list of figures. The sixty-second part of the paper provides a
 list of tables. The sixty-third part of the paper provides a
 list of figures. The sixty-fourth part of the paper provides a
 list of tables. The sixty-fifth part of the paper provides a
 list of figures. The sixty-sixth part of the paper provides a
 list of tables. The sixty-seventh part of the paper provides a
 list of figures. The sixty-eighth part of the paper provides a
 list of tables. The sixty-ninth part of the paper provides a
 list of figures. The seventieth part of the paper provides a
 list of tables. The seventy-first part of the paper provides a
 list of figures. The seventy-second part of the paper provides a
 list of tables. The seventy-third part of the paper provides a
 list of figures. The seventy-fourth part of the paper provides a
 list of tables. The seventy-fifth part of the paper provides a
 list of figures. The seventy-sixth part of the paper provides a
 list of tables. The seventy-seventh part of the paper provides a
 list of figures. The seventy-eighth part of the paper provides a
 list of tables. The seventy-ninth part of the paper provides a
 list of figures. The eightieth part of the paper provides a
 list of tables. The eighty-first part of the paper provides a
 list of figures. The eighty-second part of the paper provides a
 list of tables. The eighty-third part of the paper provides a
 list of figures. The eighty-fourth part of the paper provides a
 list of tables. The eighty-fifth part of the paper provides a
 list of figures. The eighty-sixth part of the paper provides a
 list of tables. The eighty-seventh part of the paper provides a
 list of figures. The eighty-eighth part of the paper provides a
 list of tables. The eighty-ninth part of the paper provides a
 list of figures. The ninetieth part of the paper provides a
 list of tables. The ninety-first part of the paper provides a
 list of figures. The ninety-second part of the paper provides a
 list of tables. The ninety-third part of the paper provides a
 list of figures. The ninety-fourth part of the paper provides a
 list of tables. The ninety-fifth part of the paper provides a
 list of figures. The ninety-sixth part of the paper provides a
 list of tables. The ninety-seventh part of the paper provides a
 list of figures. The ninety-eighth part of the paper provides a
 list of tables. The ninety-ninth part of the paper provides a
 list of figures. The hundredth part of the paper provides a
 list of tables.

for each transaction and are available only in relatively small numbers at a time (books of \$500, with checks of \$25, \$50, and \$100 denominations). It is to be emphasized also that, unlike credit card and check credit plans, the customer here cannot borrow until he has exhausted the balance in his checking account. Finally, there is the crucial question of the acceptance of the travelers check where the user is not known. Experience to date, with respect to the long-established travelers checks, does not indicate an easy or quick answer to this problem.

In spite of these possible drawbacks this program (or something comparable to it) may well be an attractive alternative to a credit card plan for many banks in view of the lower immediate cost and the revenues derived from interest on loans, membership fees and check processing charges. Also, according to its proponents, a potentially significant collateral benefit of the plan is the effect it might have in obtaining new depositors, attracted by the convenience and security aspects of the plan, either as a substitute for or perhaps even an addition to the consumer's present use of credit cards and/or check credit.

Implications: Some Observations

If the present interest in bank credit cards (and other kinds of plans discussed above) were to develop into



a total banking program with nationwide recognition, acceptance and interchange of card credit--it seems probable that, other things being equal, check flow would be less than might be anticipated under the present system. But, how much less, how soon and what further contributions such a "movement" might make to the evolution of the payments mechanism will depend on the nature and the extent and rapidity of spread of the various kinds of plans.

Thomas W. Gormley, senior vice president of the Pittsburgh National Bank, has stated: "Not the least of the reasons Pittsburgh National, and many other banks, are in the charge card business is the conviction that this service is a giant step toward the financial utility . . . toward the day when we have a checkless, cashless society. . . ." ¹ Similarly, president James F. English, Jr. of Connecticut Bank and Trust Company, says, "We are moving to a checkless society and we believe this [credit card plan] is the first step in it." ² Closer to the thinking of many

¹"We're in the Charge Card Business--Should You Be?" Based on presentations at the Regional Meetings of the Bank Public Relations and Marketing Association in Columbus, Ohio, April 5, and in Montreal, Canada, April 22, 1966, by C. T. Russell and D. Dougherty, Pittsburgh National Bank.

²R. A. Bennett, "New President of Conn. B. & T. Exemplifies Growing Breed of 'Scientific' Bankers," American Banker, August 8, 1966, pp. 1-2.



bankers is the position of Security First National Bank of Los Angeles. After some rather extensive research on the marketability of the Bank of Delaware Touch-Tone phone system experiment, Security First concluded that the volume potential would not justify the large investment required.

Still the research served the purpose of uncovering interest on the part of both retailers and consumers in having checks more widely accepted.

"At this point, we swung completely around in our thinking," says Mr. Stockbridge (senior vice president of Security First). Whereas the bank had started out to jump directly into the "checkless society," it decided that such a step was premature, that a series of intermediate steps was needed--steps that took the bank, customers and retailers in that direction but without the high costs of a computer-terminal system.

"We decided to make the checking account the central instrument," Mr. Stockbridge says. "We were working toward expanding and improving our present banking services, not getting into an entirely new business."¹

As already mentioned, Security First finally adopted a program which combined a Check Guarantee Card with an overdraft privilege rather than a credit card plan. In view of the presence of BankAmericard in California this choice is not difficult to understand. However, Security First had also given some thought to the possibility of a

¹J. R. Hambleton, "Security First Takes 'Calculated Risk' with New Check Guarantee Card," American Banker, July 22, 1966, p. 2.



pooled program with a group of California banks but rejected the idea on the ground that "credit cards lose much of their advantage as a competitive tool when all banks are offering basically the same service."¹

Despite references to the checkless society, clearly their most remote purpose in launching credit card programs is not, as such, to promote the checkless society but to be in the vanguard of any moves in that direction so they will not be at a competitive disadvantage if and when it arrives. More immediately, the interest in credit cards and related ideas is quite directly a result of current competitive pressures.

There is the increasing competition among commercial banks themselves and between commercial banks and other institutions for the deposits of individuals and businesses. Also, bank customers have been demanding new services. These developments have, perhaps, been especially noteworthy in the rapidly growing field of personal and installment credit. Hence, it is not surprising that bankers have referred to their credit card or related consumer credit plan as "a marketing program aimed at attracting depositors" and as "first and foremost a matter

¹J. R. Hambleton, "Bancardcheck Seeks to Provide Variation on Credit Card Theme," American Banker, July 26, 1966, p. 2.

of meeting and staying ahead of our competition." It is to be noted here again that not all banks consider a credit card plan as necessarily the best merchandizing device in the present situation; some conclude that some type of competing program may be as effective; and, as will be explained later, such competing programs if developed to a similar degree could have implications for the payments mechanism perhaps of equal significance to credit cards.

Also in the realm of competition is the relevance of advancing computer technology. As more banks make use of the computer and as they graduate to more advanced systems, they are under pressure to justify the expenditure by making more complete use of this equipment. One such use is for a credit card or similar program. In turn, it is recognized that a computerized operation improves the speed and efficiency of the service to merchants and cardholders and, perhaps equally important, gives tighter control over misuse of cards--the "runaway" card problem. In addition, the computer can be used to provide participating merchants with various types of reports in the area of marketing analysis and sales data--information which retailers may otherwise feel that they will lack if they relinquish their own credit operations too completely.¹

¹R. C. Kolb, "Computer Vital Tool for Credit Card Operation," American Banker, June 6, 1966, p. 16.



Again, as a competitive device, bank credit card programs if properly managed can be highly profitable. This has been proven by banks with programs started in the early 1950's as well as by those of more recent origin. It should be assumed here, perhaps, that "properly managed" includes not only persevering through the early period of losses and directing the program wisely but also using foresight and judgment in arriving at the initial decision that a credit card program is feasible in the given market area.¹

On this latter point, it may be of interest to examine some of the reasons advanced by banks which have rejected or are not now seriously studying the possibility of adopting programs of the type being considered here. With respect to straight single bank credit card plans, banks in Maine and Vermont indicated their belief that the population in their areas would not support the expenditure involved, that the people were too conservative and were not ready for local credit cards, that for the present at least the American Express type of card fulfilled the need. Here as well as elsewhere frequent reference was made to Chase Manhattan's experience--"If Chase couldn't make a

¹Barry Pickell and Roger Abouchar, "Look Before You Leap into Credit Card Field," American Banker, June 6, 1966, p. 16

go of it, who are we to try?" Again, the experience of several banks with revolving check credit was less than satisfactory, and this was cited as a reason for lack of enthusiasm about credit cards. In some cases, the relatively smaller banks in the urban centers felt that there was not room enough for more than one or at most two banks with credit cards, and the larger banks would have the advantage. In other instances, these smaller banks expressed some interest in regional or even national cooperative types of credit card schemes, but not as a purely independent venture.

Despite the preceding reference to the somewhat negative feelings of some banks, it should be remembered that a majority of those contacted by the Federal Reserve survey indicated that, usually for competitive reasons, they were giving serious consideration to one or more of the types of plans covered by this paper. Given the assumption then that credit cards are here to stay and that they will probably develop on a much larger scale in the near future, a question relevant to the consideration of their impact concerns the means or avenues by which the movement will progress. Bankers interviewed suggested a process of extension of at least two types--geographic and functional.

Geographically, the movement can spread locally simply by individual banks adopting their own separate plans. A second means is regional or statewide expansion through some kind of interchange arrangement, involving a pooling or joint system in which a group of banks shares some of the development costs. An excellent example of the joint system, the Midwest Bank Card, and its problems will be presented more fully later in this paper. Extension could also occur more directly at the national level by a widespread acceptance of a nationally franchised plan, such as BankAmericard, or by some type of national association for interchange purposes.¹ It is possible too that the national credit card plans for banks now being sponsored by nonbank organizations--American Express, Diners Club, Carte Blanche--may in the future become more directly competitive at the local retail card level.

The functional (in contrast to the geographic) extension of credit card refers to the extension of the processes involved, presumably in the direction of a more automatic transfer of credit. Although any discussion in this area is speculative at best, it is here that the distinction between credit cards and the other types of

¹"Association for the National Interchange of Bank Credit Cards Under Discussion," American Banker, August 18, 1966.



plans described previously may become important, simply because of the differing contribution which each may make to the evolution of the payments process.

Quite aside from the normal practices and policies of credit extension, regular bank retail credit card plans are, in many small but perhaps important ways, familiarizing the parties involved with the use of methods and equipment somewhat comparable to those so essential to the automatic transfer of credit. The use of the credit card itself points up the problem of a simple and reliable means of consumer identification, a major obstacle to any automatic transfer system. Consumers and retailers become more accustomed to the use of the imprinter, an admittedly crude sort of terminal device but perhaps a necessary beginning. Banks, retailers and consumers are even occasionally meeting the problem of the immediate credit decision whenever a purchase exceeds the "floor limit."

These aspects of the credit card type of transaction, however, seem rather far removed from what would appear to be the next logical step toward automatic credit transfer--an "on-line" system involving the instantaneous transfer of funds from the account of the consumer to that of the retailer.¹ Moreover, although many business writers appear

¹Touch-Tone Project, Storm's Shoes, Inc. with the



convinced that this is the next step and that it will occur, they disagree completely as to when. Some predict it as a matter of two or three years while others feel that it is in the much more distant future.

At this point the various kinds of plans described above as being essentially competitors of credit cards may become of crucial importance. This is especially true of those programs which are extensions of the check credit idea and involve the overdraft system in which the consumer's line of credit is tied directly to his checking account. Although the consumer uses checks rather than a charge card at the place of the transaction, he receives automatic credit at the bank if he exceeds his deposit balance. Since this overdraft feature makes "routine consumer activity possible at all times,"¹ it is an important aspect of the automatic transfer process. Hence, Robert V. Head concludes: "The institutions that have taken this step are thus progressing along the pathway toward ultimately providing for automatic credit extension at the point of a retail transaction"²

Bank of Delaware and the American Telephone and Telegraph Company.

¹R. E. Sprague, "System for Automatic Value Exchange," Banking, June, 1966, p. 120.

²Robert V. Head, "The Checkless Society," Datamation, March, 1966, p. 23.



In a footnote to this conclusion Mr. Head also says:

The reader may have observed that, also during 1965, many banks set up consumer credit card plans, patterned after the long-established BankAmericard. Given the perspective that present-day techniques for the verification and extension of credit are going to be dramatically upgraded, these bank credit card ventures must be viewed more as ill-advised retrogressions than as imaginative breakthroughs into the checkless future.¹

Although Mr. Head may be correct in this conclusion, two comments concerning it might be in order. First, the underlined portion of the statement draws attention to the premise upon which the conclusion is based: namely, that there will be drastic improvement in credit granting procedures. Clearly, Mr. Head is not asserting that credit card plans as such are a backward step. Second, the credit card movement itself may contribute significantly to the very upgrading of "present-day techniques for the verification and extension of credit" which Mr. Head poses as the basis for subordinating the present credit card developments.

Hence, it seems reasonable to conclude at this stage of the movement that both kinds of programs can contribute to the evolution of the payments mechanism

¹Ibid. Emphasis supplied.

toward a more automatic transfer system: credit card plans especially in the realm of problems at the point of the retail transaction; revolving overdraft loan types of plans particularly in the area of credit extension, by tying the customer's line of credit directly to his checking account. However, at present, credit cards are receiving practically all the attention, even to the point where the other plans are (to the irritation of their originators) confused with, or referred to as, credit card programs. Whether these types of plans can survive in competition with credit cards is a matter of conjecture.

Some evidence suggests that in the minds of many financial writers credit cards are the coming thing, and other programs are regarded as more or less interim defensive mechanisms, as perhaps not completely adequate substitutes for credit cards but ones which they do not wish their competitors to acquire either. For example, as already noted, the so-called overdraft-travelers check plan previously discussed has been accepted by over 130 banks throughout the country. However, signing up is one thing and putting into operation is another, since only three of the seven banks contacted in the Federal Reserve Bank, Boston, survey intended to implement the program within six months after signing the franchise. The other four had



no definite target date: one indicated its intention of "taking another look at the situation and then decide whether we want to proceed"; another had no specific time frame in mind "but expects it to be offered soon"; the third indicated that it signed up to forestall its competition and "we have no immediate plans for starting and do not expect it will occur for at least another year"; the fourth bank also took on a franchise for competitive reasons as another means of expanding its consumer services, but later proceeded in launching its own credit card plan, and the franchise had been shelved until its own charge card program was operating.

That the delay in implementing the franchise, after it had been purchased, is not peculiar to New England was indicated by J. R. Hambleton in his series on credit cards in the American Banker:

Some banks that signed up for it did so only to keep their competition from getting the service. Upon learning of this, Mr. Green [president of First Financial Marketing Group which is marketing the program] had the contract changed. A bank signing up from now on must make a major effort within six months or lose its exclusive franchise.¹

Hence, the future of the overdraft type of program may be less certain than that of the credit card.

¹J. R. Hambleton, "Bancardcheck Seeks to Provide Variation on Credit Card Theme," American Banker, July 26, 1966, p. 2.

Nevertheless, the overdraft feature, considered by some to be an important function in any automatic credit transfer system, has been introduced. Possibly the next development in the credit card mechanism may be the mass inducement of the cardholder to become a depositor, with an overdraft privilege tied to his checking account in lieu of the present pre-arranged line-of-credit type of authorization. If the banks succeed in this, they will have taken another step toward a more automatic transfer process in the sense that the distance will not seem so great to the substitution of an identification card for the credit card.¹

Moreover, as all of these programs (of the type covered by this paper) multiply and expand, both geographically and functionally, they will intensify the need for solving several kinds of problems which heretofore have been regarded as being almost entirely within the realm of the checkless society. For example, there are the increasing problems of (1) customer identification (more cardholders spread over a greater area), (2) standardization of equipment (especially if interchange arrangements become common), (3) faster and more accurate credit verification, extension and interchange (particularly as the "on-line"

¹Robert V. Head, "The Checkless Society," Datamation, March, 1966, p. 24.

type of procedure is approached, regardless of the steps by which it occurs). The increasing recognition of and attempt to solve these problems by individual banks and, more important perhaps, by organized groups will itself ease the way to further developments.¹

On the other hand, while credit card and similar programs may well be a step in the direction of an automatic electro-credit transfer system, there is real disagreement over the speed with which this stage will be achieved, if ever. Several "realists" have given very practical and convincing reasons for their belief that while the "checkless, cashless" society may ultimately be reached, it will be by a much slower and more tortuous process of trial and error than its planners seem to envision.

For example, while agreeing that "there is unquestionable merit in the possibilities suggested by the universal information interchange concept that leads to the 'cashless' society," A. R. Zipf, vice president of Bank of America, feels that more realism is necessary before any real progress can take place. In particular, he poses the problem of obtaining a satisfactory return on the very

¹The American Bankers Association National Automatic Conference maintains Project Committees in all the problem areas and provides for the exchange of information and new solutions.

substantial investment required by the types of systems now contemplated. Mr. Zipf, using the BankAmericard program for purposes of comparison, analyzes briefly the potential benefits and problems involved in a shift to an automatic system, "in three areas: 1) merchants' operations, 2) cardholder utilization, and 3) bank operation." Mr. Zipf finds it difficult at this time to discover sufficient net advantages to the parties most concerned in each of these three areas to justify an expectation of adequate return on the banks' investment.¹

Charles Block, vice president of Chase Manhattan Bank, reaches very similar conclusions but by a somewhat different process. In presenting "an approach suggestive of how to research the checkless society," Mr. Block finds that the check system is far from obsolete. He refers to some recent developments (e.g. better check cashing facilities, overdraft banking, automatic bill payment, payroll distribution, video tapes, credit cards, MICR encoding) as suggestive of ways in which the check system has been and can be further improved in order to enable banks to handle more efficiently the check volume and fulfill better the needs of their customers in a variety of

¹A. R. Zipf, "A Practical View of Universal Credit," Datamation, March, 1966, pp. 121-122.

ways. Hence, Mr. Block feels that for the near-term future the continued improvement of the present system is a more realistic goal than the "checkless society"; that society will probably "require more than one debt settlement mechanism in volume; for example, cash, checks, automatic money transfers"; that presently "the long term potential of the 'checkless' society is completely unknown"; that "there is little danger of it occurring overnight right under our noses before we can do anything about it."¹

These latter points of view have been mentioned not because they prove anything but simply because they seem to be in harmony with some of the data presented in this paper. While there is unquestionably a surge of interest in credit cards and related consumer credit plans the number of such programs actually in operation or immediately pending does not suggest any appreciable impact in the near future on the volume of checks² or other aspects of the payment mechanism. Nevertheless, the increasing competition among banks and between banks and other sources of

¹Charles Block, "Serious Questions Need Answers En Route to Checkless Society," American Banker, July, 28, 1966, pp. 4, 5, 9.

²In 1955, 14 billion checks were written; it is expected that by 1975 over 27 billion checks will be processed annually. The present annual cost of clearing checks is estimated at between 3.3 and 3.5 billion dollars.

financial services as well as the increasing demand for banking services (especially check volume) will surely accentuate the attempts by individual banks (and perhaps groups of banks) to maintain and improve their position through more computerization and the adoption of programs aimed at reducing, rerouting, and replacing checks. Hence, the "movement" toward the types of plans considered here could speed up significantly in the near future.

Compatible Bank Credit Cards

Overview

The compatible bank credit card has radically altered the framework of the banking industry. Every bank contemplating entry into the credit card business, as well as every existing card operation, must consider the implications of compatibility. Indeed, compatibility itself may represent a more important development for the commercial banking industry than the credit card; it may be a major step into the "checkless society."

The first compatible bank credit card system to commence large-scale operations was the Midwest Bank Card System, which began to function in November, 1966. This system was not without its problems. During the first year of operations losses occurred because of frauds as a result

of cards falling into the hands of persons other than the owners. Cards were often stolen from mail boxes, and in the mass mailing process some families received fifteen or more cards.¹ It was also reported that one card was made out to a dog in Chicago.

The adverse publicity associated with this "plunge" of the member banks in the Midwest Bank Card System resulted in introduction of the House of Representatives Bill H. R. 12646, "To prohibit federally insured banks from making unsolicited commitments to extend credit, and for other purposes."²

In testimony on this bill before the House Committee on Banking and Currency, Miss Betty Furness voiced her opinion that the issuance of unsolicited credit cards in Chicago was "a particularly offensive form of junk mail." It was her contention, and she considered it to be that of the public at large, that banks should be prohibited from mailing unsolicited credit cards.³

¹"Chicago's Credit Card Crisis," Business Week, July 15, 1967, p. 35.

²"Curbs on Credit Cards Issued by Banks Being Sought by Patman in House Bill," The Wall Street Journal, August 29, 1967, p. 28.

³Testimony of Betty Furness, Special Assistant to the President for Consumer Affairs, Before the House Committee on Banking and Currency, November 8, 1967.

Before the Committee on the same day, K. A. Randall, Chairman of the Federal Deposit Insurance Corporation defended the action of the banks involved. He pointed out the need to create a broad base as rapidly as possible and said that procedures were in effect to select out "hot cards." He supported the banks by saying:

Bank credit card plans typically require procedures for maintaining a very close tether on the individual card holder's use of the instrument. This is obviously good banking because a customer obligated beyond his means is simply a problem rather than an asset to the bank. . . . Premature and inappropriate legislation on credit cards could damage the banking system. As with any innovation, there is need for a period of testing.¹

A third person to testify was Andrew F. Brimmer, Governor, Federal Reserve System, who stated relative to mass mailing of credit cards in the Chicago area:

The banks did this with the realization that there would be some problems and some losses during the initial stages. But, as a matter of business judgment, they found this procedure helpful in order to sign up merchants. They believed that the total costs of launching their plans would have been less, even including losses, than would have been the case if a slower buildup had been undertaken through requiring individual applications for credit cards. All of the banks contacted, however, indicated that after their plans had been launched in this fashion they relied primarily on applications as a source of new cardholders.²

¹Statement of Chairman K. A. Randall, Federal Deposit Insurance Corporation, before the House Banking and Currency Committee, November 8, 1967.

²Statement of Andrew F. Brimmer, Member, Board of

House Bill H. R. 12646 died in Committee.

Within the first six months of operation, the Midwest Bank Card System instituted twenty-six changes to combat fraud. These included a "zero floor" for some merchants, who were required to clear every card purchase; confirmation of purchases with the card owner if a card was used several times in one day, and having the new card sent out by registered mail--at a cost of eighty cents per letter.¹

The trial, errors and experience of mass mailing of credit cards was not a step backward. The knowledge gained² and the successful results obtained after an initial shock of losses has made the Midwest Bank Card System a model which is now being followed throughout the nation. The Intermountain Bankcard Association with member banks in Utah, Idaho and parts of Wyoming, Nevada and Colorado was added to the growing list of regional compatible systems in December, 1967.³

Governors of Federal Reserve System, before the Committee on Banking and Currency, House of Representatives, November 8, 1967.

¹"Chicago's Credit Card Crisis," loc. cit.

²"Banks Tell First Year of Credit Cards--Hectic," Chicago Tribune, September 24, 1967.

³"Three Banks in Utah Form Group to Offer Credit Card," Wall Street Journal, December 14, 1967.

The Midwest Bank Card System¹ initially encompassed the operations of five separate bank credit cards in the Chicago area and has now been extended to cover the three states of Illinois, Indiana and Michigan. There are a number of other compatible operations in existence or contemplated, including BankAmericard, the California Bankcard Association and Interbankard. All of these plans have a great deal in common and even their differences are instructive. The focus of this section will be on compatibility as exemplified by the Midwest Bank Card System, although comparisons will be drawn to other plans.

Department store credit cards, oil company cards or airline credit cards are generally issued by a merchandiser who is prepared to accept the card in a credit transaction. This is fundamentally a two-party relationship between the merchant and the customer (Figure 1).

¹The material used in this section on Compatible Bank Credit Cards has been gathered from the Midwest Card System. Interviews were conducted December 19 and 20, 1967 with Robert M. Martindale, President, Midwest Bank Card System, Inc., and the following personnel at member banks; B. J. McGuigan, Assistant Cashier, The First National Bank of Chicago, Michael C. Thometz, Administrative Assistant, Town and Country Charge, Division of Continental Illinois National Bank and Trust Company of Chicago, and B. Kenneth West, Assistant Division Administrator, Charge Card Division, Harris Trust and Savings Bank. This writer must take responsibility for any misinterpretation of the information obtained.

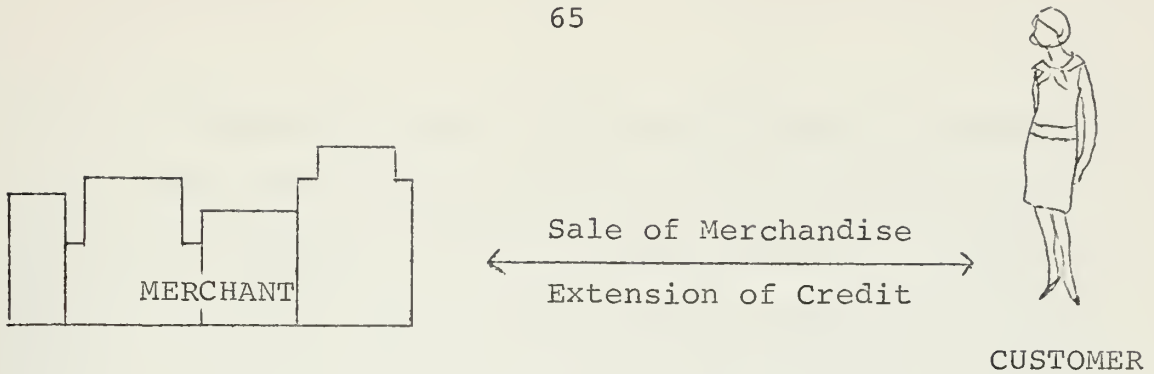


Fig. 1.--Merchant Credit Card Plan

The typical single bank credit card is issued by a bank to its customers and is accepted by any participating purveyor of goods and services, relying on the bank's agreement to assume the credit risk by purchasing the sales slips so generated on a non-recourse basis. This is in essence a three-party relationship; the single bank is the central pivot in the relationship since it issues the card to the customer and also enrolls the merchant¹ (Figure 2)

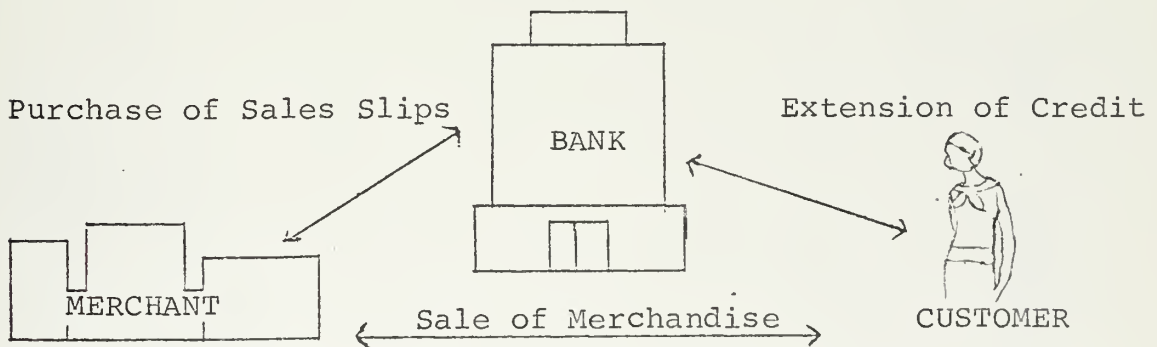


Fig. 2.--Single Bank Credit Card Plan

¹Other examples of three-party credit card systems: the most familiar are the travel and entertainment cards issued by American Express, Carte Blanche and Diners' Club.

A compatible bank credit card system is essentially a four-party relationship, since at least two banks are involved in addition to the customer and the merchant. Each bank issues cards to its customers and enrolls merchants to accept cards, with the understanding that cardholders and merchants will be interchangeable (Figure 3).

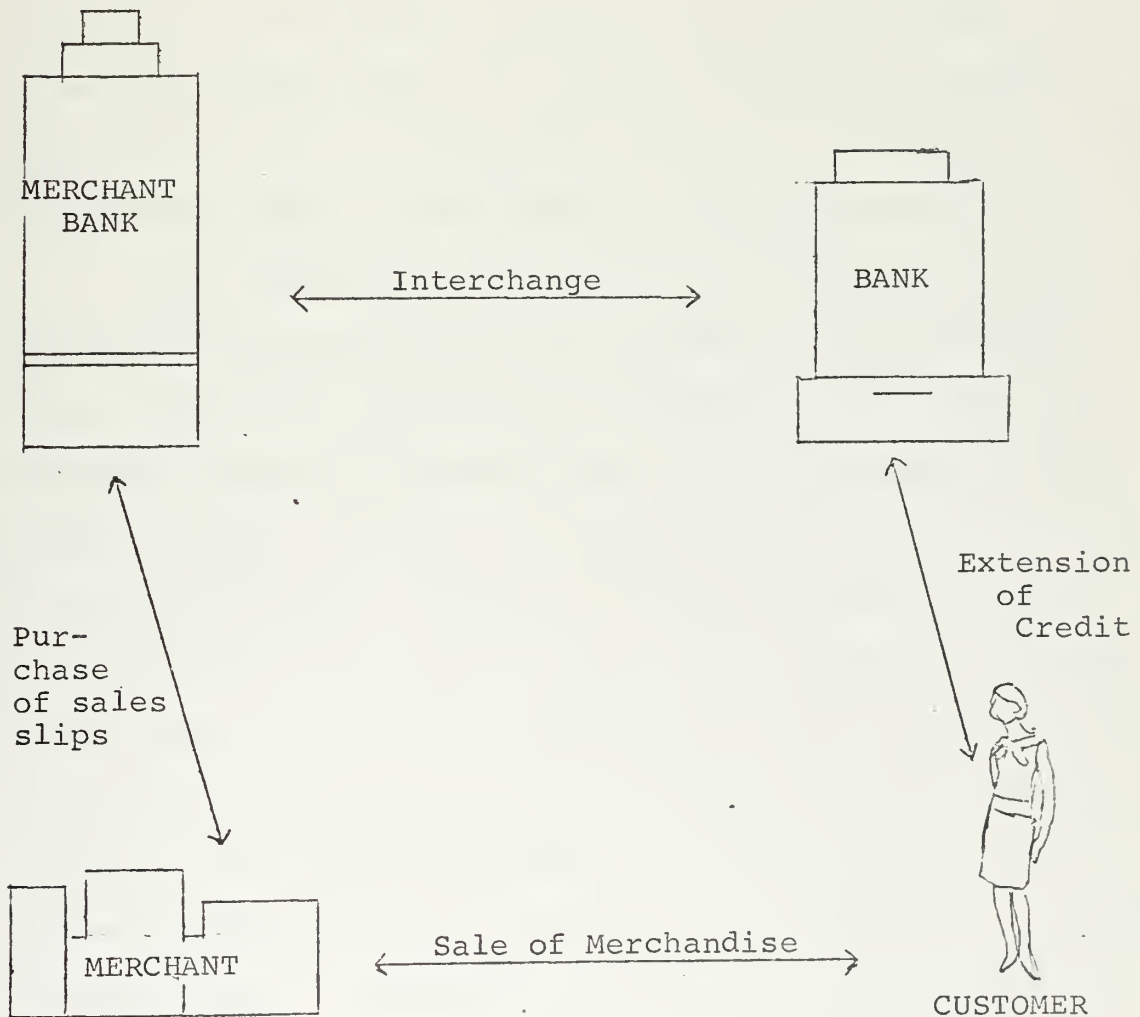


Fig. 3.--Compatible Bank Credit Card Plan

Cooperation

From the point of view of the merchant and the customer the basic principle of compatibility is simplicity itself. Every customer holding a compatible card has the right and is encouraged to use his card for every merchant enrolled in the system. The customer does not care which bank enrolled the merchant. Conversely, every merchant enrolled in the system is willing and eager to accept all compatible cards because his bank has agreed to purchase from him all sales slips generated by the use of such cards. The merchant does not care which bank issued the card.

The banks which are members of a compatible system are basically committed to the principle of interchange. When a compatible system is in operation, each member bank receives from its merchants sales slips generated by cards issued by any member banks. The primary function of a compatible system is to arrange the interchange of such slips between the "merchant bank" which purchased the sales slips from its merchants, and the "card-issuing bank" which issued the card so used. From the bank's point of view, therefore, the compatible system is one of exchanging valuable pieces of paper. Bankers are no strangers to this process, which is fundamentally the same as the existing check clearing system.

If the first basic principle is a compatible system in interchange, a cooperative activity, the second principle is, paradoxically, independence. There are two principal sources of income in the bank credit card business. The most important is the interest paid by cardholders when they elect extended payment of their revolving accounts. The other source is the discount paid by the merchant to induce the bank to purchase his credit card sales slips. In all of the existing and projected compatible systems the member banks are free to compete in these matters. Indeed, this independence extends to three areas:

(1) The customer relationship. Each member bank is free to select the persons to whom it will issue credit cards, to establish limits on the credit extended and to set its own price for the services rendered to its customers. As a corollary each member bank bears the risks and reaps the rewards of its own credit card operation.

(2) The merchant relationship. Each member bank is free to enroll any merchant in the system and to establish its own price structure in dealing with merchants. A merchant is free to deal with the bank of its choice.

(3) The correspondent bank relationship. In the Midwest Bank Card System a third dimension of independence

has emerged. Several of the larger banks which are members of the Midwest System have made arrangements with other banks, usually smaller correspondent banks, for an indirect participation in the System. By affiliating with one of the member banks, the correspondents are in a position to serve as the initial bank of deposit for their own merchants and to insure that their customers are issued Midwest credit cards. In general, the Midwest System does not attempt to govern this relationship between the member bank and the indirect "participating bank." In fact, a wide variety of arrangements have been offered to participating banks. The two areas of economic importance are the sharing of the merchant discount and the sharing of the risk and income from the cardholder relationship.

At this point it might be appropriate to make a few observations about the market functioning of a compatible credit card system, before entering into a discussion of the mechanics of such a system. One preliminary clarification must be made. Some of the existing and contemplated systems are designed primarily to achieve compatibility between bank credit card operations in widely scattered areas throughout the country. With some exceptions, this is true of the BankAmericard system involving the Bank of America and other banks which has franchised, as well

as the contemplated Interbankard system. Obviously where the member banks are widely scattered the opportunities for direct competition are at a minimum, and the primary purpose of interchange is to expand the geographic scope of acceptability of each individual bank credit card. On the other hand, the Midwest Bank Card System was conceived in the first instance as embodying compatibility in a single market in which the member banks would be in direct competition with one another. It will come as no surprise to anyone to discover that competition in the Midwest System has been intense.

Competition

This competition has extended to all three areas of independence outlined above: the customer relationship, the merchant relationship and the correspondent bank relationship.

With respect to the customer relationship it must be pointed out that virtually every bank credit card program which has been launched, whether successfully or unsuccessfully, commenced with a mass distribution of unsolicited cards. In the Midwest System the principal competitors bent every effort to obtain the maximum distribution of their own cards. The result was inevitably a certain amount of overlapping and an intense effort by each bank to promote

the use of its own card.

The area of merchant relationships was even more intensely competitive. In a compatible system a merchant need only sign with one member bank to enjoy the activity of all cardholders of all member banks. Since every member bank was selling basically the same product to merchants, that is, the same cardholder base, the struggle for merchant enrollment concentrated on various forms of price competition. This price competition was influenced by the fact that the merchant bank in the Midwest System retains the entire merchant discount or other merchant income, none of which is passed forward to the card-issuing bank (this is a result of the fact that interchange of sales slips between merchant bank and card-issuing bank takes place at par, a point which will be further discussed later). The merchant bank must bear certain expenses in connection with the enrolling of merchants and the processing of sales slips, as well as certain economic risks in connection with charge-backs, which also will be discussed below. These expenses and risks influence the pricing process.

The competition for merchants has interesting effects. In a compatible system involving banks in the same market area every merchant bank will obtain the benefits of activity at its merchants by the cardholders

of other banks. In the Midwest System it may be estimated that as much as 50 per cent of all credit card transactions involve an interchange between the merchant bank and the card-issuing bank. The precise distribution of benefits depends upon the success of each bank in obtaining valuable merchant relationships. If the compatible system, as a whole, encourages a wider use of bank credit cards in the community than a multiplicity of independent bank card systems, then the member banks will profit as well as the merchants and cardholders.

The third principal area of competition, the correspondent bank relationship, provides the clue to one peculiarity of the Midwest System. Each of the major banks which are members of the System has chosen to do business under a trade name which does not directly identify the bank in question. The reason for this is that each of these banks recognizes that its correspondents would be reluctant to participate if the name of the principal bank was prominently featured on cards issued to customers of the correspondent. The participation of correspondent banks was important to the larger Illinois banks because, in a unit-banking state, it is difficult for a large downtown bank on its own to reach a large number of retail customers and retail merchants. On the other hand, the

participating banks were given a low risk method of staying in the total bank credit card picture. Whether smaller banks will choose to go it alone, as some have done in the Midwest System, or will remain affiliated with a major card-issuing bank, only time will tell.

The compatible feature of the Midwest Bank Card System has undoubtedly fostered intense competition between the member banks. It is equally obvious that the effects of this competition have not been an unmitigated evil. First of all, the principal competitors in the Midwest System would have been competitors even if the system did not exist. Indeed, but for compatibility, there would probably be at least four separate bank credit card operations in Chicago today. The result would probably have been chaos in the minds of both the cardholders and merchants. Until the Midwest System began operations, most bank credit card plans operated without any significant competition from other banks in the same market area. Obviously, this situation will not continue for long as banks everywhere enter the business. Competition is inevitable; only the form competition will take is open for discussion. This leads to the second point. The existence of intense competition in a compatible framework has maximized the market impact of the introduction of bank

cards in the Midwest area. The system is working; activity is high; all of the members stand to profit from this fact in the long run.

The Card

Bank credit systems are almost universally based on the familiar plastic credit card with embossed characters used to imprint the customer's name and account number on the sales slip. In a compatible system the cards have uniform physical specification so that each merchant will be able to use one standard imprinter. The physical standards are easy to establish. The tough question, however, concerns the appearance of the compatible card, because the two basic principles of compatibility and independence yield conflicting answers. The independence of the member banks suggests that the card of each bank have a different appearance to enhance product identification. On the other hand, compatibility requires that each customer instantly recognize every merchant establishment where he may use his card and that every sales person in a merchant establishment instantly recognizes all acceptable cards. This recognition is normally achieved by reproducing the card format in a decal to be displayed by the merchant. Obviously, if each member bank has a unique card format, no merchant could possibly display all of the relevant decals

and confusion would be inevitable.

The Midwest Bank Card System has solved this problem by adopting a common logo identifying the system and a common visual format for the card and merchant decal (Figure 4). Each member of the Midwest System is entitled to use its own distinctive "sub-system" trade name or symbol on its cards so long as the uniform visual impact of the card is not disturbed. All merchant decals are identical and do not refer to any such "sub-system." BankAmericard and California Bankcard Association have adopted a similar solution, with even less opportunity for sub-system identification. All of these systems have in effect decided that a uniform format is necessary in order to communicate the idea of compatibility and that sub-system identification must take a subordinate position.

On the other hand, the present position of Interbankard is that each card-issuing bank will be entitled to maintain its own unique card format. Interbankard plans to adopt a common system logo, but this logo may be placed anywhere on the back or front of the card. The merchant, on the other hand, would presumably display two decals, one identifying his local card affiliation, the other a special Interbankard decal carrying the system logo.

Only experience will resolve the question raised by

System logo

Member Bank symbol

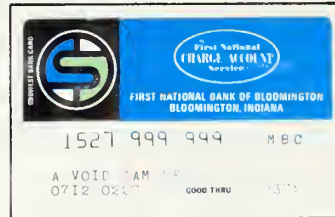
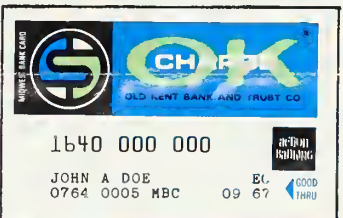
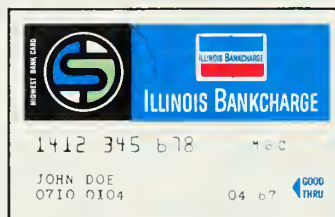
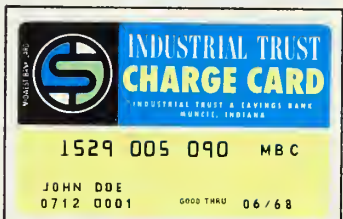
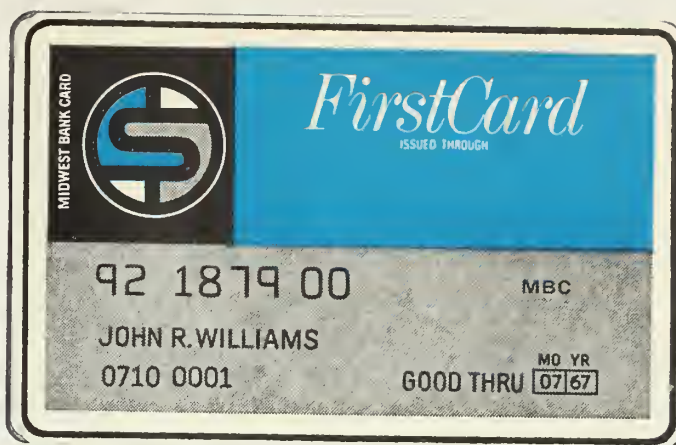


Fig. 4.--Card Format

these two approaches. If the Interbankard approach works, it will be relatively simple to create a nationwide compatible bank card since no existing card-issuing bank will be required to make any drastic changes to its card. On the other hand, if compatibility will only work with a more or less uniform card format, then the transition to a uniform national card may require sacrifices by all existing card issuers. The answer to this question may be different depending on whether compatibility is conceived as operating in a local market between competitors or in an inter-market context. As was pointed out earlier, current trends indicate that the inter-market context might be short-lived as card systems proliferate in many local markets. In a local market situation with maximum interchange between cards, the uniform format might well be essential.

There is another important aspect to the card format problem. A bank may wish to distinguish between those of its cardholders who are entitled to use their cards in the local market and those who have nationwide privileges. If a national compatible credit card system adopts a rigid uniform card format, any particular bank which wishes to issue national cards only to some of its cardholders will have to issue a different card for card-

holders with local privileges only. If the national system only requires a national logo somewhere on the card, the bank can easily distinguish between cardholders with national and local privileges.

Customer Relations

Since the essence of a compatible system is the interchangeability of all compatible cards, great care must be taken that all merchants treat all cardholders equally. The contract between the merchant bank and the merchant must obligate the merchant to accept all compatible cards and to do so without discrimination in terms. The merchant cannot refuse to accept the compatible card of an issuer with which he has no merchant agreement. It is also normal to provide that the merchant will treat credit card transactions on the same terms as cash transactions.

Non-discrimination at the merchant level must be reinforced by equality of treatment at the merchant bank level. If the merchant must accept all compatible cards, the merchant bank must agree to accept all sales slips generated by such cards, including, obviously, those of other card-issuing banks. Similarly, the merchant bank cannot discriminate between different compatible cards in dealing with merchants; for example; the merchant bank cannot establish different discount rates for purchasing

sales slips generated by different cards. If the merchant bank were permitted to so discriminate, the merchant would inevitably favor the cards which carried the lower discount rate.

Operating Rules

Every compatible bank credit card system must have some uniform operating rules governing the various aspects of credit card transactions. Many of these rules are relatively non-controversial. For example, almost all bank credit card plans instruct the merchant that he is free, without further ado, to consummate a card transaction under a specific dollar amount, say \$50, which is generally referred to as the "floor limit." The merchant is required to contact an authorization center for permission to accept the card in a transaction over the floor limit, if he expects the bank to accept the sales slip on a non-recourse basis. The authorization center has current credit information on each account and is in a position to make a credit judgment on each transaction. An authorization, once given, is noted on the sales slip. The floor limit is obviously an important protective device and is also an effective way of repossessing credit cards being fraudulently used or those where the customer has seriously exceeded his credit limit.

From a marketing viewpoint it is important that the sales person in the merchant establishment need not remember a different floor limit for each card he honors. Hence, most compatible situations have established a uniform floor limit which may vary by merchant category, but is the same for all compatible cards at any one merchant.

This example leads naturally to another operating characteristic system--the charge-back. The merchant bank places into clearing all sales slips generated by cards of other card-issuers and the latter banks are required to accept all such slips. If, however, a given slip evidences a transaction in excess of the floor limit and no authorization was granted to the merchant, the card-issuing bank may charge the slip back to the merchant bank. This charge-back technique is one of the basic sanctions for preserving the integrity of the system. The Midwest System discovered in the course of its operations that many such charge-back provisions are required, covering a broad range of problems in addition to the floor limit. Additional examples of such charge-backs include sales slips involving cards on the hot card list or expired cards, sales slips presented after a specified time has elapsed from the date of the transaction, and so on.

A compatible system occasionally introduces an

unavoidable element of inflexibility into a credit card system. The problem of customer complaints is a good example of this. Inevitably, some customers will be dissatisfied with the goods or services received from a merchant and will not receive satisfaction from the merchant. Until the customer receives satisfaction, he simply will not pay his account. In the typical single bank credit card system, the bank usually attempts to insulate itself from such problems by providing in the merchant agreement that the merchant will be responsible for resolving all such complaints and will accept charge-backs whenever the customer so complains. Frequently, the cardholder agreement also provides that the cardholder will pay the bank even though there is a dispute with the merchant. Despite these provisions, the bank is in the middle. Some merchants have a sufficiently strong bargaining position so that the bank cannot insist on automatic charge-back in every case of customer complaint and some customers are sufficiently important to the bank so that it will not pursue a dissatisfied customer. As a practical matter, therefore, the bank must often act as an arbitrator between the customer and the merchant. Sometimes the bank is left holding the bag.

In a single bank system these problems are troublesome but since there is only one bank involved its judgment

will ultimately control the situation. However, in a compatible system customer complaints will arise in cases where the merchant bank and the card-issuing bank are different. One way to solve the problem would be to set up a system of arbitration between banks in which the arbitrator would decide whether the customer or the merchant is right. In the Midwest System this solution was rejected and the rule was adopted that the merchant bank must accept a charge-back where the customer has made a written complaint. The merchant bank then must decide whether or not to pass the charge-back on to the merchant.

The Central Facility

The Midwest Bank Card System, like most other compatible systems, has found it necessary to create a separate entity to manage the operations of the system. This has taken the form of a not-for-profit membership corporation, the formal organization of which will be briefly discussed below. At this point, attention will be given to the role of the central facility in the operations of the system. At the present time, the Midwest central facility has two principal functions. First, it is the owner of the rights to use the system service marks: the name "Midwest Bank Card" and the system logo and card format. All member banks are licensed to use these service marks in connection

with their credit card operations.

The second function of the Midwest central facility is to formulate and enforce the rules for the operation of the system. Some of these rules have already been discussed, such as the physical and visual specifications of the Midwest credit card, the establishment of floor limits and charge-back rules. These operating rules have developed from a four-page statement of general principles into a set of documents running for more than 75 pages. Although the assistance of outside consultants and other technical experts was essential in the process of rule-making, the major credit for the development of these rules must go to the banks themselves. As they began to operate a compatible system, they attempted to solve the problems which arose, one by one. The development process continues.

The Midwest Bank Card System has not attempted to create a central facility which would perform extensive services for the member banks in connection with their credit card operations. On the other hand, the California Bankcard Association is contemplating such an active central facility. In that association, the central facility will maintain substantial computer installations which will perform virtually all of the processing related to merchant and cardholder accounting and the clearing function. In

addition, by contractual arrangement with an independent corporation, the California Association apparently will centralize the credit authorization function in one agency, following the separate instructions of each member bank for transactions over the system floor limits.

Member Bank Responsibility

In the Midwest System, on the other hand, each member bank is responsible for processing its own paper, maintaining its own computer facilities, purchasing its own supplies, doing its own advertising and operating its own credit authorization centers. Apart from the licensing of the system service marks, the only services performed by the system are to provide a simple clearing mechanism and to arrange for the publication of a system-wide hot card list. However, even these services have been kept to a minimum. The clearing function, for example, is simply the designation of a time and place where the member banks meet each day and purchase from one another the sales slips to be interchanged. The hot card list, which is made up of cards which merchants are notified not to honor, is published by the system but is distributed by each merchant bank to its own merchants.

There is, by the way, nothing in the Midwest rules to prohibit one or more banks from pooling their resources

and creating an active central facility to perform functions such as those to be performed by the California Bankcard Association. The Midwest System simply has not yet felt any pressing need to engage in such activities.

Clearing Process

It is probably too early in the development of compatible bank credit card systems to say very much about the clearing mechanism as such. The Midwest System, for example, is using the most primitive clearing mechanism. Interchange is accomplished simply by a reciprocal purchase of sales slips presented at the interchange. Other systems have been proposed to utilize the facilities of the normal check clearing system, but a description of these proposals is beyond the scope of this paper. Eventually a system will undoubtedly be developed to permit the electronic transfer of information concerning credit card transactions. Experience will undoubtedly bring about greater sophistication in this area.

There is, however, one important question of principle involved in the clearing process. This concerns the treatment of the discount or other fees paid by merchants for the privilege of selling sales slips to the merchant bank. It has already been pointed out that the basic principle of independence requires that the merchant

discount rates be independently set by the merchant bank. This is true in all existing and contemplated compatible systems. However, there is considerable variation in determining the bank which ultimately receives the merchant discount. Three principal alternatives may be identified:

(1) In the Midwest System the entire merchant discount is retained by the merchant bank, that is, by the bank which enrolled the merchant in the system. (In those cases where a correspondent bank acts as an intermediary between the merchant and the full member of the system, there is often a sharing of the discount between these two banks, but this is only a detail.)

(2) In the BankAmericard system the entire merchant discount is passed forward from the merchant bank to the bank which issued the card used in a particular transaction. In Interbankard, an interchange assessment, which is normally less than the merchant discount, is passed forward from the merchant bank to the cardholder bank.

(3) In the proposed California Bankcard Association the merchant bank retains the merchant discount; however, it is contemplated that merchant banks will be required to pay fees to the active central facility based on their merchant activity which will cover the expenses of the facility and a joint advertising program, and also provide for a

small payment to the card-issuing bank on every transaction based on one of its cards.

Opinions obviously differ on the proper recipient of the merchant discount. There are many arguments relating to the respective contributions of the merchant bank and the card-issuing bank but these cannot finally resolve the question. The Midwest experience in operating a compatible system in a local market does suggest two observations; first, as has already been mentioned, in a local compatible situation, there is a great deal of reciprocal interchange of sales slips, in which each bank earns merchant discount on the activities of the cardholders of other banks. Since the income flow is reciprocal, the net gain or loss to any bank under the Midwest rule is much less than the total amount of interchange, although there are indeed some banks which benefit more than others. Secondly, the rule that the merchant discount remains with the merchant bank greatly simplifies the clearing process. Since all clearing is at par, there is no need to compute discounts or any other compensating fee. If the compatible bank credit card system is to become a national system, involving a large number of independent banks interchanging with one another, it is obvious that clearing at par will be almost essential. This simplification may justify marginal inequities in the income flow from the merchant discount.

Formal Organization

A compatible system is generally governed by an active board of directors or other governing body selected by the member banks. In the Midwest System, the board of directors is elected using a system of weighted voting in which each member bank receives voting rights generally proportionate to its activity as a merchant and card-issuing bank. The voting rights at any membership meeting are distributed in accordance with the following formula:

(a) 5 per cent of the votes are distributed to the members on a per capita basis; each member shares equally in this portion.

(b) 20 per cent of the votes are distributed to the members in proportion to the number of merchant transactions handled in the preceding calendar quarter.

(c) 75 per cent of the votes are distributed to the members in proportion to the number of sales slips billed to cardholders in the preceding calendar quarter.

Furthermore, election of directors is by cumulative voting which assures that the majority will rule and the minority will be represented. By the same token, the normal expenses of the Midwest System are generally distributed in accordance with the same formula, so that voting power and financial responsibility are parallel. Of course, the

Midwest System, which is primarily a rule-making body, has relatively small expenses compared to those which would be incurred by a system with an active central facility.

Scope of Bank Credit Cards

The increased participation of banks in the credit card business is of interest to the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board. Beginning in April, 1967, these agencies have required Call Reports which provide information concerning bank credit cards and check credit plans.

As of April 25, 1967, 627 insured commercial banks reported outstanding credit under either credit card or check credit plans for a total amount of \$809 million. The October, 1967 report indicated an increase in number of banks to 848, reporting \$1,137 million outstanding credit under the plans.¹

With the increased importance of bank credit cards the Federal Reserve System's examiners are reviewing and appraising the policies and practices followed by the banks. The Call Report will be a continuing procedure to provide information to the Agencies.

¹Statement of Andrew F. Brimmer, loc. cit.

Electro-Banking

The use of such terms as "moneyless banking" or the "checkless, cashless society" is bringing attention to what has been referred to as a futuristic era of superautomation and supercredit.¹

Many reasons are advanced for the adoption of the new and exciting types of money transfers. Paper work involved in the movement of checks has increased to a rate that threatens to paralyze the banking industry's present network for transferring funds. Tests have been conducted on the use of cards and on-line computers for the transfer of funds, and further studies are being conducted by the American Bankers Association.

Walter E. Trabbold, comptroller of the Bank of Delaware, after conducting two on-line tests, is of the opinion that electro-banking is feasible.²

There are no technical reasons why banks shouldn't begin looking into an expansion of this magnitude in scope of their customer services. The pilot project with the shoe chain has showed us that the requirements for a small system can easily be met by equipment available now. Large-scale systems

¹"Money Goes Electronic in the 1970s," Business Week, January 13, 1968, p. 54.

²Walter E. Trabbold, "A New Perspective on Banking Automation," Progress in Information Systems. Printed by the Bank of Delaware, Wilmington, Delaware, March, 1967, p. 17.

pose some equipment problems, but none that won't disappear before such a system could be implemented.

Mr. Trabbold goes on to make the point of the importance of increasing customer service as a requirement in the coming age of electro-banking.

The biggest problem banks face is marketing. . . . Marketing is not a major factor in reducing costs; it is in making profits through customer services. . . . Recognizing and exploiting the customer-service opportunities presented by the new technologies will require a higher degree of marketing creativity than the banking industry has shown in the past.

Full electro-banking will require the use of on-line computer equipment with transfer terminals capable of connecting any merchant with any bank.¹ Most experts in the field envision the complete program of the capability of positive identification of the customer at each transaction fully developed within the next ten to fifteen years.

Although the technology of the computers, the method or methods of positive identification of customer, security and information files are not within the scope of this paper, the "end-product" is considered as a part of the customer services referred to by Mr. Trabbold. This

¹In 1958, automation participation was limited to approximately 200 banks; in 1966, according to a survey by the American Bankers Association, there were 943 banks with computers, 2,055 banks using off-premises computer services and 1,358 banks in the active automation planning stage.

"end product"--the monthly statement of transactions including the automatic deposit of salary and wages, credit card and check transactions, and interest on loans or overdrafts is no doubt the part of electro-banking of greatest interest to the customer and reflects the scope of customer services which will be marketed.

The flexibility in the use of a customer's banking services is demonstrated in the explanation of the following "typical" statement of an "electro-account" (Figure 5).

The statement is similar to those many Americans are now accustomed to receiving from their banks each month. An examination of the details, however, points out some of the changes electro-banking will bring.

The first line under the bank's name and Mr. Doe's address reads "summary data for account 809-76-8304 as of 2-28-67." The number 2-28-67 represents the date of the statement. However, the other number is an important element of electro-banking. It is Mr. Doe's Social Security number, which many informed sources contend will be the personal identification number that will serve every citizen of the United States in all financial and government transactions. Thus, for income tax, bank accounts, social security and other purposes, one number will be used to identify each American.

MR. JOHN DOE
806 KENT DRIVE
NEW CITY N.Y.

FINANCIAL INSTITUTION
ELECTRO-BANK SERVICE
Monthly Statement

SUMMARY DATA FOR ACCOUNT 009-70-0104 AS OF 2-23-67

CLOSING BALANCE	\$ 32.63	AVAILABLE LINE OF CREDIT	3,000.00
AMOUNT DEPOSITED	\$1872.00		
P-\$1800.00		CHARGES	CODE NO.
T-\$ 32.00		PRE-AUTHORIZED-P	10
I-\$		TRANSFERS	12
C \$ 40.00		CASH TRANS.	2
AMOUNT WITHDRAWN	\$2069.86	INQUIRIES	
P-\$ 484.31		SERVICE CHARGE	3.10
T-\$ 707.62		LINE OF CREDIT-\$291.17 FOR 3 DAYS	.30
I-\$ 857.73		TOTAL CHARGE	3.40
C-\$ 20.00			
BALANCE INQUIRIES-4			
2-04 2-11 2-18 2-26			

TRNFR. DATE	ITEM	TRANS. DATE	CODE	AMOUNT	DISCOUNT	DEBIT	CREDIT	BALANCE
2-01	BALANCE FORWARD	2-01						\$ 280.86
2-02	STERN'S DEPT. STORE	2-02	P	80.16		80.16		200.50
2-03	U.S. STEEL-PAYROLL	2-03	P	800.00			800.00	1000.50
2-03	SAVINGS ACCT. TRNFR.	2-03	I	250.50		250.50		750.00
2-04	NORTHERN SEL-NTG.	2-04	P	210.00		210.00		540.00
2-05	ACP FOODSTORES	2-02	T	40.00		40.00		500.00
2-06	PUBLIC SERVICE	2-06	P	32.15		32.15		467.85
2-07	GIMBELS-MOSE. RETURN	2-02	T	12.00			12.00	479.85
2-08	PERSONAL NOTE PAY.	2-08	I	200.00		200.00		279.85
2-08	ACP FOODSTORES	2-05	T	25.00		25.00		254.85
2-09	BEST & COMPANY	2-09	T	50.00	1.00	49.00		205.85
2-10	CASH WITHDRAWAL	2-10	C	20.00		20.00		185.85
2-11	FOODFAIR SUPERMARKET	2-10	T	20.00		20.00		165.85
2-11	ST. ANDREWS CHURCH	2-11	P	25.00		25.00		135.85
2-11	MACYS DEPT. STORE	2-07	T	40.80		40.80		94.05
2-13	JCB DEPT. STORE	2-12	T	20.00	.50	20.22		65.83
2-14	N.Y. TELEPHONE CO.	2-14	P	32.00		32.00		33.83
2-15	MERRILL LYNCH	2-11	T	325.00		325.00		-291.17
2-18	U.S. STEEL-PAYROLL	2-18	P	800.00			800.00	508.83
2-21	SAVINGS ACCT. TRNFR.	2-21	I	200.00		200.00		308.00
2-22	WILLIAM SMITH	2-19	T	20.00			20.00	320.00
2-22	AUTOMOBILE PAYMENT	2-22	I	110.00		110.00		210.00
2-23	WESTINGHOUSE APPL.	2-23	P	25.00		25.00		185.00
2-25	A.T.&T.-DIVIDENDS	2-25	P	200.00			200.00	385.00
2-25	SAVINGS ACCT. TRNFR.	2-25	I	85.00		85.00		300.00
2-26	ACP FOODSTORES	2-23	T	60.00		60.00		240.00
2-27	TONYS MILK CO.	2-24	T	52.00		52.00		187.70
2-27	CASH DEPOSIT	2-27	C	40.00			40.00	227.70
2-27	MYRTLES DRESS SHOP	2-22	T	61.00		61.00		166.20
2-28	AETNA INS. CO.	2-28	P	80.00		80.00		86.20
2-28	TOTAL CHARGE	2-28	I	3.40		3.40		82.80

AMOUNT PRE-AUTHORIZED FOR MARCH 1967- \$750.00

Source: The New York Times, May 21, 1967

Fig. 5.--Electro-Bank Monthly Statement

Starting on the right side of the statement the next entry reads "available line of credit \$1,000.00." In the electro-banking society almost everyone will have an automatic credit available, the amount of which will depend on the customer's monthly income and credit risk rating.

The type of charges, their frequency and cost are shown next. The first charges listed are pre-authorized, symbolized by the letter P. Pre-authorized charges and deposits represent one of the major steps toward the checkless society. It means that payroll checks, dividends and other monies that are accrued regularly during the year will be deposited automatically in the bank account. In the case of pre-authorized charges, items such as mortgage loans, utility bills and insurance premiums will be deducted automatically.

The second type of charge is telephone transfers. The touch-tone telephone permits data to be sent over telephone wires into the bank's computers.¹ Cash transfers will also be made over the touch-tone telephone using local merchants for the distribution of the cash.

At the end of each month a statement such as this

¹Proven successful in the Bank of Delaware, Storm's Shoes Test Program. Francis F. Smulski, "Touch-Tone Project," Progress in Information Systems, op. cit., p. 57.

will be sent to Mr. Doe, but inquiries can be made at any time. Four inquiries were made during the month, probably by Mrs. Doe, at a total cost of 60 cents to the account.

The total service charge to Mr. Doe's account was \$3.10 but at some time during the month he withdrew \$291.17 more than he had on deposit. The bank's computer, seeing that Mr. Doe has an advance line of credit of \$1000.00, immediately entered the credit for the \$291.17 at a charge of 30 cents for three days. The total bank charge on the account for the month came to \$3.40.

On the left side of the statement is shown a summary of the dollar amount of the month's transactions.

The itemized listings of transactions are made in a nine-column chart. The first column shows the date that the funds were transferred either into or out of the account. The second column lists the items while the third column shows the actual date of the transaction. The fourth column identifies the type of transaction, the fifth the amount and the sixth registers whether any sort of discount was given. Debit, credit and balance records fill the remaining columns.

The first item in the statement shows the balance from the previous month of \$280.66. The second item is the preauthorized payment of \$80.16 to Sterns Department Store. The next item is the automatic preauthorized transfer of Mr.

Doe's earnings by United States Steel to the bank account.

In the fourth transaction the bank computer has automatically transferred \$250.50 to Mr. Doe's savings account because the amount of funds available in the account at the moment exceeded a present limit.

The fifth item is a preauthorized mortgage payment.

The sixth item shows the purchase of \$40 worth of goods from the A & P food stores. It also demonstrates one of the merchandising techniques that will come with the checkless society. It is notable that the date of the transaction in the third column was February 2 while the date of fund transference was not until February 5. What happened was that when Mrs. Doe presented her cash card to the A & P clerk to pay for the groceries, the transaction was recorded but the funds were not transferred because the store was offering three days' money float as a buying incentive in much the same way Green Stamps or other stamps are offered today.

Another incentive offered by stores in the checkless society will be the discount for immediate payment such as the item on February 9 when Best & Company gave \$1 discount on \$50 worth of merchandise because the funds were transferred immediately. Yet another nuance of finance in the checkless society took place on February 11 when Mr. Doe on

a "hot" tip paid \$325 to the brokerage house of Merrill Lynch, Pierce, Fenner & Smith, Inc. The tip, whether it was good or not, resulted in an overdraft of \$291.17 on his account.

Because of the automatic line of credit that will become concurrent with checkless society, the bank's computer just borrowed the necessary sum and Merrill Lynch was none the wiser.

If the consensus of experts is right, the checkless society will be a cheaper, faster and more efficient way in which to handle money matters.

A. R. Zipf, executive vice president of the Bank of America, in answering his own question, "You want to know what is the next step in the automation of money?" states the requirement necessary to make electro-banking a reality, and gave his solution for Mr. Trabbold's "biggest problem banks face" with, "It's getting out and selling these new services."¹

¹"Electronic Money," Forbes, April 1, 1967, p. 46. Emphasis supplied.

CHAPTER IV

SUMMARY AND CONCLUSION

The problems which the military family faces with regard to financial affairs are caused primarily by the requirement of moving and establishing its financial status at each new location. In Chapter II many of these problems were outlined, and to the person who is faced with the problems they appear even more monumental than can be described in any paper. The military departments have made a provision to aid in the transfer of funds. This is a mail version of what the bank of the future envisions, i.e. the military man can have his salary sent directly to the bank for later disposition. In fact, as Chapter III describes, in individual parts and combinations of mail and computers, all the features of electro-banking are now available. The questions, can this be of use to the military family, and how, are the points of this thesis.

Military Banking Program an Aid

The term Military Banking Program as used in this paper refers to a procedure utilizing military pay in conjunction with civilian banking procedures to provide the

best service possible for military personnel wherever they are in the world. Such a program can very definitely be an aid. Civilian banks already have available the services to provide ready and acceptable cash, check, and credit transactions. An integrated service such as that of the Bankers Trust of New York which provides guaranteed checks with an automatic line-of-credit, together with the compatible credit card program as being operated by the Midwest Bank Card System, could be the simple solution to the financial problems of military families. The use of a service or social security number as the account number would make it easy for the military family to remember. Insurance is also available to lessen the problems of lost cards. With an account number the same as the social security or service number, lost card information could be quickly called into the bank as soon as the loss was discovered.

Implementation and operation of such a program would require the support of top military and civilian personnel at the service level and in the Office of the Secretary of Defense. It would require that the "complete package" of services be available from the participating banks. There would need to be an interchange of paper between merchant banks and cardholder banks which would cover the entire United States. The interchange would not be unlike the

method now used for clearing checks through the Federal Reserve System. Publicity would be an aspect of such a program that cannot be overlooked. The military families would need to know that the program was available and what services it could provide. It would be essential that merchants be aware of the program and hopefully most would participate in the system, especially in and near towns with large military family populations.

Bank Services Available

The use of an allotment to transfer the pay of a military person to a bank account each month constitutes not only a service to the military family involved, but is an asset to the bank. The bank has the use of this money until a check written on the account clears or until a credit card charge appears against it. The bank can depend on receiving the deposit on the first of each month; in one case, the amount a financial institution receives in military allotments each month is in excess of \$2.6 million.

The services that could be made available by a bank in exchange for the allotment business from a service family should include the three mentioned earlier: a checking account (including the guarantee card), a compatible credit card (no charge if paid within thirty days, or deducted from the account each month), and line-of-credit (a service

charge or interest rate based on either a daily overdraft position or amount outstanding at the end of the month). These three basic services would allow the military family to establish their "credit standing" at one bank, and to continue to do all their basic banking there (by mail) while using its services all over the world. Thus, there would be no need to draw special pay while in transit. With military pay allotted to the same bank each month regardless of where the service member is located, his family could either use the credit card or cash a check for its needs. If the family needed a "small loan" they would simply utilize the line-of-credit. The amount of the line of credit available to them would be established by the bank based on length of service, basic pay, size of the allotment, and history of the account.

With these services available, the military wife would not have to wait for the allotment check to arrive before doing her weekend shopping, and the family could plan their money flow during a period of transfer and at Christmas time. There would be no need for the family to request a loan each time a small amount was needed; they could use the prearranged line-of-credit and pay back the loan as scheduled.

Services for both Military and Civilian

Total banking with the services as suggested above is compatible with civilian needs. Provision of a single card for all the banking services discussed is a natural extension of the various systems of cards now being used. For civilians a deposit could be made either by paycheck or cash; many companies now directly deposit in the bank the entire payroll for the company. The Navy has over 728,000 personnel who are potential customers for a total banking program. There are presently over 3.5 million active duty personnel in the military services who would provide an excellent base on which to begin a total banking service with military pay. The military services as a group could be the starting point for such a program but additional customers would come from the civilian population. If the program were used by both, the larger number of accounts would make it more attractive to merchants and thereby provide greater services to those participating in the program.

Organization

Members of two organizations have shown a deep and continuing interest in the developments being made toward the "checkless society," more recently referred to as

electro-banking. George W. Mitchell and Andrew F. Brimmer, both Governors of the Federal Reserve System, and Dale L. Reistad, Director of Automation, The American Bankers Association, have repeatedly expressed the opinion that a program such as described in this paper is the stepping stone toward the "checkless society" and electro-banking. Since the Federal Reserve System and the American Bankers Association have conducted studies, published papers and held conferences on all aspects of the banking services advocated by the research findings in this paper, they would be the most logical places to begin the program of Total Banking with Military Pay. It would also be necessary for the Department of Defense to actively participate in efforts to bring about a program using military pay procedures as its basic input. Responsibility for the implementation of this type program would be interfaced at the military department level and the bank concerned. A precedent for this type of joint effort to provide a needed service to military personnel was established in 1965. At that time, the Department of Defense, in conjunction with a concordant of civilian life insurance companies, started to provide military personnel with an automatic life insurance coverage of \$10,000, at the rate of \$2 per month,¹ probably one of

¹Servicemen's Group Life Insurance, provisions of

the best programs available anywhere.

Ultimately, the organization of and responsibility for the program of Total Banking with Military Pay must rest with the three principals named above: the Department of Defense (the input and recipient of the services), the Federal Reserve Board (the regulator of banking services), and the banks themselves hopefully represented by the American Bankers Association (the provider of the services). Close cooperation among these three organizations would help facilitate the establishment of a successful program.

Conclusion

The conclusion of this paper is that it is now feasible to establish a program of Total Banking with Military Pay. The research conducted here reveals that all of the money services of electro-banking are now either available or in the planning/testing stage. Although many bankers can see only to the boundaries of their own towns, some already realize the importance of offering a full line of services to military personnel, and indeed, there are bankers who see the day when electro-banking eventually will be available to everyone. There is now a need to bring

subchapter III of chapter 19, title 38, United States Code (P.L. 89-214) announced to the Navy by Secretary of the Navy Instruction 7220 of 8 October 1965 (ALNAV 68).

these services together into a coordinated and integrated program. The procedures of making deposits by allotment of military pay and the use of checks, compatible credit cards and automatic line-of-credit would utilize the postal and delivery services in effect at the present time. Paper movement in this program will be reduced when the on-line transfers and use of computers finally bring into being the "checkless" or "less cash" society--more properly called electro-banking. An important consideration which comes to light in this paper is that such a comprehensive military banking program could provide a solution to many of the money handling problems of military families. By relieving the military wife of money flow pressures this type of program would enhance their morale and the resultant morale of the service member.

Recommendation

The research conducted in writing this paper leads to a strong recommendation, that those services now available in the banking industry should be used to aid the military family with its money flow problems. This type of action, first of all, will require the support of the Office of the Secretary of Defense. Also, the Federal Reserve Board may have to assist in the full implementation of such

a program, which could be nation-wide in scope, since some banks may need to be persuaded to offer these services to military personnel.

The recommendation of this paper to both the banks and the military departments can be taken from a quotation of A. R. Zipf, executive vice president of the Bank of America: "It's getting out and selling these new services."¹ If the banks do succeed in selling total banking services to the military the results will be of great mutual benefit.

¹"Electronic Money," Forbes, April 1, 1967.
Emphasis supplied.

SELECTED BIBLIOGRAPHY

Public Documents

U. S. House of Representatives. H.R. 12646. A Bill to prohibit federally insured banks from making unsolicited commitments to extend credit, and for other purposes.

Books

Anderson, Allan H., et al. An Electronic Cash and Credit System. New York: American Management Association, 1966.

Gentle, Edgar C. Jr., ed. Data Communication in Business. New York: American Telephone and Telegraph Company, 1965.

Schnee, Donald R. Progress in Information System. Wilmington: Bank of Delaware, March, 1967.=

Articles

"Association for the National Interchange of Bank Credit Cards Under Discussion," American Banker, August 18, 1966.

"Bank Credit Cards and Related Plans," New England Business Review, December, 1966, pp. 3-7.

"Banking by Phone," The Bell Telephone Magazine, Winter, 1964-65.

"Banks Tell First Year of Credit Cards--Hectic," Chicago Tribune, September 24, 1967.

- Bennett, R. A. "New President of Conn B & T Exemplifies Growing Breed of 'Scientific' Bankers," American Banker, August 8, 1966, pp.1-2.
- Block, Charles. "Serious Questions Need Answers En Route to Checkless Society," American Banker, July 28, 1966, pp. 4, 5, 9.
- "Charge Accounts at the Chase," Business Week, October 5, 1958, p. 96.
- "Charge It!" United States Investor, September 27, 1967.
- "Charge It Plan That Really Took Off, The" Business Week, Feb. 27, 1965, p. 58.
- "Check Cashing on Navy Ships," Navy Comptroller Review, December, 1967, p. 3.
- "Checkless Society Fascinates ABA," Datamation, July, 1967, pp. 79-80.
- "Checkless Society, The: Solution or Problem?" United States Investor, October 16, 1967.
- "Checkless System May Come Slowly," The National Bank Examiner, December, 1967, pp. 1-2.
- "Chicago's Credit Card Crisis," Business Week, July 15, 1967, p. 35.
- "Computer Talks Back, The" Data Processing Magazine, October, 1966, pp. 58-62.
- "Curbs on Credit Cards Issued by Banks Being Sought by Patman in House Bill," The Wall Street Journal, August 29, 1967, p. 28.
- "Electronic Money," Forbes, April 1, 1967, pp. 42-46.
- "First Phase A-OK, All Systems Go," Business Review, Federal Reserve Bank of Philadelphia, November, 1965, pp. 10-13.
- Hambleton, J. R. "Bancardcheck Seeks to Provide Variation on Credit Card Theme," American Banker, July 26, 1966, p. 2.

- _____. "Security First Takes 'Calculated Risk' with New Check Guarantee Card," American Banker, July 22, 1966, p. 2.
- Hammerton, J. C. "Is the Consumer Ready for 'Checkless Society?'" Bankers Monthly Magazine, Nov. 15, 1967, pp. 37-39.
- Head, Robert V. "The Checkless Society," Datamation, March, 1966, p. 23.
- Johnson, Robert. "Credit--and Credit Cards," Monthly Review, Federal Reserve Bank of San Francisco, September, 1967, pp. 171-177.
- Kaufman, Felix. "Data System that Cross Company Boundaries," Harvard Business Review, Vol. 44, No. 1, January/February, 1966, p. 141.
- Kramer, Robert L. and Livingston, W. Putnam. "Cashing in on the Checkless Society," Harvard Business Review, Vol. 45, No. 5, September/October, 1967, pp. 141-149.
- Kolb, R. C. "Computer Vital Tool for Credit Card Operation," American Banker, June 6, 1966, p. 16.
- Lee, Norris F. "What's This 'Checkless Society' All About?" Financial Executive, June, 1967, pp. 18-26.
- Mitchell, George W. "Effects of Automation on the Structure and Functioning of Banking," American Economic Review, May, 1966, pp. 159-166.
- "Money Goes Electronic in the 1970s," Business Week, January 13, 1968, pp. 54-76.
- Pickell, Barry and Abouchar, Roger. "Look Before You Leap into Credit Card Field," American Banker, June 6, 1966, p. 16.
- "Plans for Implementation of the 'Checkless Society,'" EDP Weekly, July 10, 1967, pp. 4-5.
- Reistad, Dale L. "The Coming Cashless Society," Business Horizons, Vol. 10, No. 3, Fall, 1967, pp. 23-32.

"Security First National Bank of L.A. Will 'Go National' Through License with Other Banks," American Banker, May 25, 1966.

Sprague, R. E. "System for Automatic Value Exchange," Banking, June, 1966, p. 120.

"Three Banks in Utah Form Group to Offer Credit Card," Wall Street Journal, December 14, 1967.

Trabbold, Walter E. "A New Perspective on Banking Automation," Progress in Information Systems, Bank of Delaware, Wilmington, Delaware, March, 1967.

"What the Credit Card Business is All About," The Credit Union, Vol. 32, No. 11, November, 1967.

Zipf, A. R. "A Practical View of Universal Credit," Data-mation, March, 1966, pp. 121-122.

Periodicals

American Banker. New York. August, 1966 - January, 1968.

Chicago Tribune. August, 1967 - December, 1967.

Congressional Record. August - November, 1967.

New York Times, The. June, 1966 - February, 1968.

Wall Street Journal, The. June, 1966 - February, 1968.

Washington Post, The. June, 1967 - February, 1968.

Reports

American Bankers Association. Proceedings National Automation Conference 1966. New York: American Bankers Association, 1966.

_____. Proceedings National Automation Conference 1967. New York: American Bankers Association, 1967.

Central Charge Service, Inc. Annual Report, 1967.

National Cash Register. Annual Report, 1966.

Unpublished Material

Brimmer, Andrew F. Statement before the Committee on Banking and Currency, House of Representatives on H.R. 12646. "To Prohibit Federal Insured Banks from Making Unsolicited Commitments to Extend Credit, and for Other Purposes. November 8, 1967.

Furness, Betty. Remarks before Consumer Bankers Association, Colorado Springs, Colorado. September 19, 1967.

_____. Remarks before the Missouri Credit Union League, St. Louis, Missouri. November 17, 1967.

_____. Statement before the Committee on Banking and Currency, House of Representatives on H.R. 12646. "To Prohibit Federal Insured Banks from Making Unsolicited Commitments to Extend Credit, and for Other Purposes. November 8, 1967.

Mitchell, George W. "Automation and Banking Structure." Remarks at the American Institute of Banking, Philadelphia Chapter, Forum Philadelphia. March 8, 1967.

_____. "Confrontation Within Banking: Machines vs. Bankers or Bankers With Machines." Remarks at the National Automation Conference of the American Bankers Association, Chicago, Illinois. June 6, 1966.

_____. "Tomorrow's Money as Seen Today." Remarks at the Annual Stockholders meeting of the Federal Reserve Bank of Boston, Boston, Massachusetts, October 6, 1966.

_____. Statement before the Legal and Monetary Affairs Subcommittee of the Committee on Government Operations, House of Representatives. February 9, 1966.

Randall, K. A. Statement before the Committee on Banking and Currency, House of Representatives on H.R. 12646. "To Prohibit Federal Insured Banks from Making Unsolicited Commitments to Extend Credit, and for Other Purposes. November 8, 1967.

Reistad, Dale L. "Developments in the "Checkless Society."
Address before the Management-Operations-Trust
Conference of the Maryland Bankers Association,
Baltimore, Maryland, November 9, 1967.

_____. "Implications of the Checkless Society."
Address before the Ninth Annual Conference on
Electronic Data Processing, Retail Research Insti-
tute, NRMA. Washington, D. C. September 26, 1967.

_____. "Practical Approach to Checkless Banking, A."
Address before the Marketing Department of The
American Bankers Association. Americana of New
York. March 10, 1967.

Interviews

Central Charge Service, Inc., Washington, D. C. Personal
interview with Mr. J. J. Lockwood, General Credit
Manager, November 29, 1967.

_____. Personal interview with Mr. Duane J. Novosedliak,
Assistant Secretary, November 29, 1967.

First National Bank of Chicago, The, Chicago, Illinois.
Personal interview with Mr. B. J. McGuigan, Assist-
ant Cashier. December 19, 1967.

Harris Trust and Savings Bank, Chicago, Illinois. Personal
interview with Mr. B. Kenneth West, Assistant Divi-
sion Administrator, Charge Card Division. December
20, 1967.

Midwest Bank Card System, Inc., Chicago, Illinois. Personal
interview with Mr. Robert M. Martindale, President.
December 19, 1967.

Navy Federal Credit Union, Washington, D. C.. Personal
interview with Captain R. Cobb, SC, USN (Ret.)
Manager. November 24, 1967.

Town and Country Charge, Division of Continental Illinois
National Bank and Trust Company of Chicago, Chicago,
Illinois. Personal interview with Mr. Michael C.
Thometz, Administrative Assistant. December 20, 1967.

thesG122

Total banking with military pay :



3 2768 001 00555 6

DUDLEY KNOX LIBRARY